No. 13,039

IN THE

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a National Banking Association, and EUGENE J. O'RILEY, as Trustee in Bankruptcy of the Estate of UNITED PRODUCE COMPANY, a Corporation, Bankrupt,

Appellants,

vs.

MERCHANDISE NATIONAL BANK OF CHICAGO, a National Banking Association,

Appellee.

Brief of Appellant Eugene J. O'Riley, as Trustee in Bankruptcy of the Estate of United Produce Company, a Corporation, Bankrupt

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PARKER PRINTING COMPANY, 180 FIRST STREET, SAN FRANCISCO

SUBJECT INDEX

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PRELIMINARY STATEMENT

As will appear hereafter, this appellant was originally brought into this case as an interpleaded defendant, and his position in this appeal depends entirely on that of the other appellant Bank of America National Trust and Savings Association (hereinafter referred to as "Bank of America"). Reference is therefore made to the opening

brief of such appellant for a statement as to jurisdiction and the facts of the case. This appellant joins with the Bank of America in its argument as presented in its opening brief, and urges this Court that the judgment of the court below be reversed for the reasons therein stated. This brief will be confined to a statement of this appellant's position in the case and on this appeal.

STATEMENT OF THE CASE AND APPELLANT'S POSITION ON APPEAL

This action was originally brought in the District Court of the United States for the Northern District of California by the appellee, Merchandise National Bank of Chicago (hereinafter referred to as "Merchandise"), against the appellant Bank of America to recover on a deposit account allegedly held by the former with the latter. Upon filing its answer to the complaint, the defendant Bank of America included therewith its interpleader counterclaim, subsequently amended (R. 48, *et seq.*), in which it alleged in effect that, assuming the merit of defenses set forth in its answer, it had in its possession the sum of $30,920.36 in a deposit account in the name of Frank C. Lofendo (hereinafter referred to as the "Lofendo account"), to which it made no claim. It then alleged that conflicting claims were being or might be made to the Lofendo account by four parties, to wit: plaintiff Merchandise, Frank C. Lofendo, Cy Mouradick and this appellant, Eugene J. O'Riley (hereinafter referred to as the "Trustee"), as Trustee in Bankruptcy of United Produce Company, a corporation, and prayed for an order of the court requiring such alleged claimants to interplead among themselves concerning their

alleged claims (R. 52, 53). Pursuant to such prayer and upon ex parte motion by the Bank of America, the District Court entered its order interpleading said four parties and summoning them to answer the complaint and interpleader counterclaim (R. 6).

In response to such order and summons, the following positions were taken by the four interpleaded parties prior to and during the course of the trial, and were held at the conclusion thereof:

(a) Merchandise filed its reply to the interpleader counterclaim, averring that if it received judgment as prayed in its complaint, there would be no balance in the Lofendo account to be interpleaded, but declaring that in the event it should not be so entitled to judgment, it "does claim" the said $30,920.36 (R. 18, 19).

(b) Frank C. Lofendo filed his disclaimer, disclaiming any interest in the Lofendo account (R. 7).

(c) Cy Mouradick first filed his answer to the complaint and to the interpleader counterclaim, claiming a lien against the Lofendo account (R. 22-26), but subsequently on motion of Merchandise and the Trustee during the course of the trial, his pleading was ordered stricken (R. 680-682), and his claim therefore dismissed.

(d) The Trustee filed his answer to the complaint and reply to the interpleader counterclaim alleging that the Lofendo account was in fact an account of the bankrupt, United Produce Company, and praying judgment for the entire balance thereof (R. 20, 21).

The office of an interpleader action is to adjudicate the rights of possible claimants to a common fund and thereby protect the stakeholder from multiple liability. Ordinarily,

the existence of the fund is established by its payment into court. In this case, however, it was implicit in the pleadings that the trial court had first to decide the main issue* between the plaintiff and defendant banks in order to establish the existence or non-existence of a fund for distribution to one or more of the interpleaded parties. If Merchandise were to recover judgment as prayed, Bank of America would admittedly have a right of set-off against any apparent balance in the Lofendo account, and the account would be in fact overdrawn. Thus in rendering its judgment for Merchandise, the court below *ipso facto* negated the existence of a fund to be interpleaded, and the issue between Merchandise and the Trustee, as remaining interpleaded claimants thereto, was rendered moot and never tried. On that basis, the Trustee's claim to the $30,920.36 in response to the interpleader counterclaim was dismissed (R. 115, Conclusion of Law XI).

The Bank of America is taking its own appeal from such judgment (R. 167). The Trustee is appealing from that part thereof dismissing its claim to the Lofendo account made in response to the interpleader counterclaim, on the ground that if this court should reverse the judgment of the court below on the main issue between the two banks, there would then come into existence the fund for which interpleader was sought, and the trial court should then be required to hear the respective claims of Merchandise and the Trustee thereto.

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*The term "main issue" is used herein to connote the issues raised by plaintiff's complaint and defendant Bank of Ameriea's answer thereto, as distinguished from issues raised by defendant's three counterclaims or its interpleader counterelaim and the various replies thereto.

CONCLUSION

If the judgment of the court below in favor of plaintiff Merchandise shall be reversed by this Court, that part of such judgment (R. 116-118, 117) dismissing the interpleader counterclaim and response thereto of the Trustee, including his answer to the complaint, should likewise be reversed.

Respectfully submitted,

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Dated: December 10, 1951.

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Brief for Appellee Merchandise National Bank of Chicago in Answer to Brief of Appellant Bank of America N. T. & S. A. and Brief of Appellant Eugene J. O'Riley, Etc.

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STATEMENT OF THE CASE

A. Nature of the Proceedings:—The Appeal Is an Attack on Findings and an Effort to Retry Facts.

This is an appeal by the defendant, Bank of America N. T. & S. A., from a money judgment in favor of the plaintiff, Merchandise National Bank of Chicago. There is another appellant,

The notation "R. ...." refers to the record. "Br. ...." refers to the brief of appellant Bank of America N. T. & S. A.

All emphasis in quotations has been added.

O'Riley, but he admits that he has no case unless the defendant should prevail. We answer his appeal at page 116, infra. The appellant Bank of America will hereafter be referred to, generally, as defendant and appellee as plaintiff.

Federal jurisdiction is founded solely on diversity of citizenship,[1] and no federal questions are involved. As defendant concedes (Br. p. 17), the case is therefore governed by state law under *Erie R. R. Co. v. Tompkins,* 304 U.S. 64.

The applicable law is that of California; Illinois law applies to the extent that the California rules of conflict of laws permit, since some of the events occurred in Illinois.

This is a fact case. It was tried, without a jury, for 10 trial days. There were 16 witnesses and many exhibits. The District Court made an unusually complete set of findings (R. 95-116).

At every turn defendant's brief collides with express findings or proper inferences from them. It reads like an argument addressed to a trial court and is an attempt to have this Court find the facts differently than the trier did.[2] Although defendant states that "the important facts * * * are undisputed," it asserts that its appeal is based, not only on alleged errors of law, but also on "erroneous * * * inferences drawn by the trial court from the undisputed facts" (Br. p. 6).

But drawing inferences of fact is the province of the trial court. Such inferences are themselves fact, and findings thereon are like any other findings, controlling unless clearly erroneous. *United States v. Fotopulos,* 180 F.2d 631, 635 (9 Cir.);[3] *Walling v. Gen-*

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[1]The plaintiff is a citizen of Illinois and the defendant of California (Findings I, II and III, R. 95, 96).

[2]Cf. Specifications of Error, Appellant's Br. pp. 11-14.

[3]This Court said in the *Fotopulos* case:

> "And the trial court having made them, any attempt on the part of the appellate court to 'draw an inference of fact constitutes a "usurpation of the province of the trial court" ' ".

As said in *Estate of Bristol,* 23 Cal.2d 221, 143 P.2d 689, "when two or more inferences can be reasonably deduced from the facts, the reviewing court is without power to substitute its deductions for those of the trial court."

eral Industries Co., 330 U.S. 545, 550; *Widney v. United States,* 178 F.2d 880, 884 (10 Cir.); Advisory Committee's notes to R.C.P. Rule 52. And here, as we shall show, the inferences drawn are the only tenable ones.

Although the essence of the appeal is an attack on findings, many of them are unassailed, including crucial ones. In relating the facts we shall rest on the findings, unless a finding is attacked or more detail will be helpful.

It was to defendant's interest to make the facts seem complicated and confused. Actually they are so simple that elementary legal principles decide the case.

B. Nature of the Action.

Defendant's brief begins with a misstatement. It describes the judgment as one by which plaintiff recovers "payments" made by it to defendant. In fact, this is an action by a depositor in a bank against the bank to recover the balance in a deposit account (R. 61).

In 1948 plaintiff had a deposit account with defendant (Finding IV, R. 96). Consequently, defendant was plaintiff's debtor. On November 23, 1948, plaintiff, the creditor, made demand on defendant, the debtor, for payment of the entire credit balance. As found, the account then had a credit balance of $386,577.61 (Finding XXX, R. 113). After long delay defendant paid part of the balance, insisting that it had paid in full. But it left unpaid $203,047.60. The judgment was for this amount, plus interest (Finding XXX, R. 113; Conclusion X, R. 115; Judgment, R. 117).

The controversy revolves around two debits entered by defendant against the account of its depositor, the plaintiff, in November 1948: (1) A debit of $113,216.50, and (2) a debit of $89,813.10.

The issue in the case was whether defendant had the right to make or stand on those debits. The trial court found that it did not.

C. The Facts.

1. TWO UNASSAILED FINDINGS ON CARDINAL FACTS UNDERCUT APPELLANT'S CASE.

There are two cardinal facts which distinguish this case and render all defendant's citations irrelevant. Both are found, and neither finding is assailed.

(a) The "Lofendo" Account at Defendant's Branch Was an Account of United Produce Co: "Lofendo" Was United Produce.

A company known as United Produce Company had an account in Chicago with plaintiff bank (Finding V, R. 97). At defendant's East Bakersfield branch in California an account was maintained in the name of "Frank C. Lofendo." But that account was just another account of United Produce, just "another pocket." Although there was a natural person named Lofendo, he had no interest in the account or in any check going through it regardless of the presence of his name. The District Court so found and stated that the account would thereafter be referred to "as the 'Lofendo account,' but only for convenience" (Finding VI, R. 97).

The court further found (Finding VII, R. 97):

> "That from time to time United Produce Company drew checks on its account with the plaintiff payable to 'Lofendo,' endorsed them with the name of 'Lofendo' and delivered them to defendant's branch, and they were sometimes received for deposit in its account, the so-called 'Lofendo account,' and sometimes for collection; that while the payee on those checks was designated 'Frank C. Lofendo,' United Produce Company was in fact the payee using the name 'Lofendo' to designate itself * * * that while * * * there was a natural person named Frank C. Lofendo, that person had no interest or claim in said 'Lofendo account' or in any checks drawn by United Produce Company on the plaintiff payable to 'Frank C. Lofendo' or in any of their proceeds."

The nature and purpose of the Lofendo account were a major item of proof on plaintiff's case, they were overwhelmingly established,[4] and the findings are not assailed.

(b) United Produce Co. Was Perpetrating a Fraud.

The next cardinal fact is that United Produce was perpetrating a criminal swindle, that the purpose of maintaining the "Lofendo" account in defendant's branch was to assist it to do so, and that the account was a mere instrumentality used by it in this fraud. Thus Finding VII states (R. 98):

> "that from time to time United Produce Company drew checks on its said 'Lofendo account' at defendant's branch payable to itself under the designation 'United Produce Co.' and delivered them to the plaintiff for deposit to its account with plaintiff or for collection; that upon delivering such checks to plaintiff for collection, United Produce Company falsely represented to plaintiff that the checks were actual remittances from a natural person named 'Lofendo,' that 'Lofendo' was a debtor of United Produce Company, and that the checks were payments received by United Produce Company from Frank C. Lofendo on account of debts owing to it from him arising from the sale of produce; that the purpose of United Produce Company in maintaining the 'Lofendo account' and in drawing checks on its two accounts in the manner just stated was to cheat and defraud plaintiff;"

United Produce's account with plaintiff, in Chicago, was maintained under an agreement whereby checks received by plaintiff from United Produce and represented to be remittances from debtors were received for collection, and conditional credits were entered in the account subject to charge-back at any time before actual collection of the funds (Finding VIII, R. 99).

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[4]E.g., testimony of Lofendo, R. 1194-5, Gassman, R. 1196-1257, Howell, R. 588, and exhibits introduced in connection with Gassman's testimony, R. 745-749, P. Ex. 24-30. Most of these exhibits were not printed, since this Court made an order permitting reference without printing.

Between November 4 and 12, 1948, plaintiff received from United Produce over $500,000 of checks drawn by United Produce on its 'Lofendo' account, and gave conditional credit. These checks were fraudulent and were backed by no funds. Concurrently United Produce was perpetrating other frauds on plaintiff such as obtaining credits on the basis of fictitious collateral (Finding IX, R. 99).

As a consequence of these frauds, on November 12 and 15, 1948 there was an *apparent* credit balance in United Produce's account with plaintiff. But in fact there was no credit balance at all. Instead there was an overdraft exceeding $500,000 (Finding X, R. 100).

These findings are fully supported (e.g., R. 221-223, 230-243), and they are not really questioned. Defendant does assert that the balance in United Produce's account with plaintiff ought to be called a "real" credit balance because the $500,000 of bad checks had been received by plaintiff in connection with remittances on old loans, new loans were made to United Produce Co. on the assumption that the old loans were paid and on the security of fictitious collateral, and the amount of the loans was placed to United's credit on the commercial ledger (e.g., Br. 26, et seq.).

But this is a mere quibble of characterization. The essential fact is not contested: the apparent credit arose from fraudulent use of worthless checks and non-existent collateral. And on November 12 and 15, not only did plaintiff owe United nothing, but United was overdrawn well in excess of $500,000. We discuss this matter further at pages 46-50, infra.

2. THE SIX CHECKS FOR $113,216.50.

In this state of affairs United Produce drew six checks on its account with plaintiff payable to itself under the name of Lofendo, totalling $113,216.50. It mailed them to defendant's branch

where they arrived on November 13, 1948. Defendant declined to receive them for deposit but accepted them only as agent of the payee for collection.[5] *It did not give any credit thereon to the Lofendo account* (Finding XI, R. 100).

This is another cardinal fact of the case.

Since United Produce was Lofendo, defendant became United Produce's agent for collection. Defendant then "mailed the 6 checks by a 'collection letter' to the plaintiff for collection" (Finding XI, R. 100). They reached plaintiff on November 15th; "they never were in fact paid or collected; * * * United Produce Company did not * * * have any funds in the account with which to pay the 6 checks or against which they could be collected" (Finding XII, R. 100). But plaintiff's employees, deceived and misled by the fraud referred to above, assumed that there were funds in the account sufficient to meet the checks, perforated the checks "paid," made bookkeeping entries on plaintiff's internal records accordingly, and mailed to defendant an "advice of credit" to the effect that the 6 checks had been collected (Finding XIII, R. 101).

The Messenger-Estribou Conversation, November 17th.

Two days later, November 17th, plaintiff discovered the fraud perpetrated on it by United Produce. Its controller and vice president, Mr. Messenger, immediately telephoned to defendant and spoke to defendant's Branch Manager, Mr. Estribou.

Mr. Messenger stated that plaintiff had just discovered that United Produce had been perpetrating fraud on it and had swindled it out of a very large sum of money. He informed defendant that an advice of credit for the $113,216.50 had been mailed, said that it had been sent out by mistake and as a result of the fraud, and stated that the 6 checks had not in fact been collected or paid (Finding XIV, R. 101).

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[5]Appellant's brief (p. 7) incorrectly states that the branch "received [these checks] for deposit." The contrary was stipulated, R. 1175, 1176.

He asked whether defendant had received the advice of credit and was told no. Thereupon he notified defendant that it was rescinded and revoked. Defendant then *agreed* with plaintiff not to act upon the advice of credit if and when received and further agreed to return it to an emissary of plaintiff, Mr. LeRoy, who would fly out for it (Finding XIV, R. 102).

Two facts may be emphasized:

1. Defendant did not know that the advice of credit had been sent out until this telephone conversation. Its first knowledge of what had occurred in plaintiff's offices in Chicago relative to the 6 checks came with the information that what had happened was in error and was rescinded and revoked (Finding XIV, R. 102).

2. *Defendant had not yet given any credit on the 6 checks to the Lofendo account, had not paid out a penny to anyone in reliance thereon and had not acted in any way on the supposition that the checks had been collected* (Finding XVII, R. 103).

Events of November 18th.

The next day, November 18th, plaintiff's Executive Vice President, Mr. LeRoy, arrived in San Francisco. What then happened is succinctly *found* (Finding XV, R. 102):

> "* * * both orally and in writing [plaintiff through LeRoy] advised defendant that the 6 checks had not been collected, that the advice of credit had been sent out by mistake, that it was rescinded and revoked, and that the plaintiff rescinded any authority to the defendant to make any charge to plaintiff's account with defendant in reliance on the advice of credit when and if received * * *"

The finding continues (Finding XV, R. 103):

> "that on the same day defendant agreed that it would not act upon the advice of credit when received, that it would return the advice of credit to plaintiff, and that plaintiff should return the 6 checks to defendant; that on the same

day plaintiff again advised defendant orally and in writing that United Produce Company had defrauded plaintiff of a sum in excess of $500,000 by the means and instrumentality of fraudulent and fictitious checks drawn by United Produce Company on the account maintained at defendant's branch in the name of Frank C. Lofendo, and that Lofendo was a participant in the fraud."

Plaintiff did return the 6 checks after marking them with a notation "Cancelled in error" (Finding XVI, R. 103).

Defendant Ignores the Instructions and Violates Its Commitment.

On November 19, 1948, the advice of credit reached defendant (Finding XVII, R. 103). But defendant coldly refused to return it to Mr. LeRoy. The next day, acting in what it admits was an "unusual" manner (R. 182), it charged plaintiff's deposit account with the sum of $113,216.50 and credited a like amount to the "Lofendo" account (Finding XIX, R. 104).

Defendant purported to do this on the authority of the advice of credit. And it made entries on its own books purporting to show collection of the 6 checks as of November 19th (Finding XIX, R. 105).

The District Court found (Finding XIX, R. 104):

"that the said charge against the account of the plaintiff was made without any authority from plaintiff to do so, contrary to plaintiff's instructions already received by defendant and already agreed to by it, and without any legal right, and it was wholly insufficient to reduce the defendant's indebtedness to the plaintiff by any amount whatever."[6]

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[6]Evidence supporting the findings relative to the Messenger-Estribou telephone conversation of November 17th and relative to what happened when Mr. LeRoy came to San Francisco on November 18th is contained in stipulations (R. 445-7, 1175-76), in letter (P. Exs. 10, 11, R. 1171, 1174A), in testimony of Messenger (R. 220-6), of LeRoy (R. 448-67), of Duncan (R. 518, 519, 523-37, 542-60), of Johnson (R. 691-702), and of Estribou (R. 339-50, 359-402).

Trial Court's Conclusions as to the $113,216.50.

The trial court concluded as follows:

Conclusion IV: "That the rescinded and cancelled advice of credit is not and cannot be the basis for credit, claim, charge or set-off by defendant against plaintiff" (R. 114).

Conclusion V: "That defendant never acted to its detriment in reliance upon the rescinded and cancelled advice of credit" R. 114).

Conclusion VII: "That defendant's charge of $113,216.50 against the account of plaintiff was made without authority or right and did not reduce defendant's indebtedness to plaintiff" (R. 114, 115).

Reason for Defendant's Untoward Conduct.

Defendant's conduct was the result of the crassest motives. The facts are summarized in Findings XX-XXIV, inclusive (R. 105-107):

As early as October 22, 1948 defendant became suspicious that the "Lofendo" account was being maintained as part of a check-kiting operation of United Produce Company. It thereupon instructed its employees not to accept for immediate credit any checks drawn by United Produce to the order of Lofendo but to take them as agent for collection only, giving credit only when collection was actually effected by receipt of good funds, and no checking against any such items was to be permitted until collection was so completed.

On November 10th defendant's suspicion hardened into conviction: "On November 10, 1948 defendant became positive that the transactions going on between 'Lofendo' and United Produce Company were not ethical but were part of some dishonest scheme" (Finding XX, R. 105).

Because of this belief, entertained as early as October 22nd and hardened into conviction on November 10th, *defendant thereupon imperatively reiterated its instructions to its employees.*

For several days defendant heeded its own instructions. Then, on November 16th it received from United Produce through the mail checks aggregating $97,207 drawn by United to the order of "Lofendo". Contrary to its instructions, defendant's employees negligently received these for deposit and gave the "Lofendo" account immediate credit. Then, on the same day, they negligently honored checks drawn on the "Lofendo" account and paid out over $109,569. By so doing defendant paid out over $96,000 more than the true collected balance.

Late on November 18th it received a wire from its Chicago correspondent [not plaintiff] that the checks for $97,207 had been rejected for lack of funds. Its officers immediately examined its records and discovered what its employees had done in violation of instructions.[7] Defendant thus learned that it had sustained a loss of over $96,000.

If it could only get funds, somehow, into the "Lofendo" account against which it could charge back the rejected checks for $97,207, it might retrieve its loss. It cast about for some way to do so. Fortuitously, plaintiff's advice of credit concerning the $113,-216.50 arrived the very next morning, November 19th. Seizing upon this advice of credit, ignoring plaintiff's prior instructions and its own commitment, defendant charged plaintiff's account with $113,216.50, credited that sum to the "Lofendo" account, and concurrently charged the "Lofendo" account with the sum of $97,207. It did these acts "all for its own benefit" (Finding XXIV, R. 108).

Stating it bluntly, defendant had been robbed by United Produce Company, and so it turned around and sought to rob plaintiff.[8]

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[7]"Q. You were astonished?
"A. That is putting it mildly." (R. 374)

[8]Evidence supporting these findings may be found in P. Exs. 12 and 13 (R. 1174B, 1174C), testimony of Estribou (R. 359-75, 388, 418-19, 422), testimony of Cosgrove (R. 433-40), of Tarr (R. 560-565), and stipulation (R. 1178-1182).

There Is No Element of Estoppel.

The findings make another cardinal fact clear. Defendant's loss of $96,000

> "was in no way connected with the 6 checks for $113,216.50 or anything that had occurred with respect to those 6 checks either at the defendant's offices or at the plaintiff's offices or with anything that had been done relative thereto by the plaintiff or the defendant; that the loss was the sole and proximate result of defendant's own carelessness and negligence, as aforesaid" (Finding XXIII, R. 107).

Again (Finding XVIII, R. 104):

> "That at no time did defendant give anything of value to anyone for the said 6 checks or any of them or any part thereof."

And again (Finding XVII, R. 104):

> "at no time did the defendant in any way take any action whatsoever in reliance on the advice of credit relative to the 6 checks or in reliance on the supposed collection or payment of the said checks, and in no way at any time did it ever change its position or suffer any prejudice in reliance on any supposition that the said 6 checks or any of them had been collected or paid."

3. THE CONTRACTUAL ARRANGEMENT BETWEEN THE PARTIES FOR THE COLLECTION OF THE CHECKS.

Before relating the facts concerning the other debit charge of $89,813.10, we note another major fact in the case. That is the contractual arrangement between the parties covering the collection of the checks.

Finding.

The trial court found the terms of the contract thus:

> "throughout the year 1948 plaintiff had a deposit account with the defendant with a large credit balance in plaintiff's

favor; that during the existence of that account, defendant from time to time sent to plaintiff for collection checks drawn upon the plaintiff; *that in such cases, defendant was authorized by plaintiff to charge plaintiff's said account with the amount of the checks, and would so charge the account only upon actual receipt from the plaintiff of a written authorization to do so, in the form of an outstanding and unrevoked credit memorandum or advice of credit; that this was the uniform custom, practice and arrangement between plaintiff and defendant* and was observed by defendant at all times until November 19, 1948" (Finding IV, R. 96).

This is a finding that, under the contract of the parties, collection and payment by plaintiff of checks sent to it by defendant for collection was not deemed made by any bookkeeping apparatus in Chicago or by anything short of a charge against plaintiff's account with defendant in San Francisco upon written authorization, received and alive.

This finding controls the case. As we shall show, it renders defendant's basic arguments pointless.

Now defendant does not assail the finding. It simply ignores it entirely. Yet the sole question can be this: Is the finding supported by the evidence? We therefore demonstrate that it is.

The Evidence Supports the Finding Overwhelmingly.

The agreement between the parties governing collections was composed of (a) the writings and documents used, (b) uniform usage and custom of banks relative to the meaning of the particular documents, (c) the uniform practice between plaintiff and defendant in such cases, and (d) the agreement between "Lofendo" and defendant.

The Document Used Was a "Collection Letter," Which Differs from a "Cash Letter."

The 6 checks for $113,216.50 and the 4 checks for $89,813.10 (discussed at pp. 16-25, infra) were sent by defendant to plaintiff

by "collection letters", not by "cash letters". (So admitted, Br. 14-16; also R. 1175-76, 1268.)

The difference between "cash letters" and "collection letters" is a major fact in the case and was so recognized by all at the trial (R. 411, 412). The parties stipulated (R. 1186) thus:

> "In the banking business throughout the United States checks are transmitted by banks to other banks for collection either by means of 'cash letters' or 'collections letters'.
>
> "*In the case of cash letters, the forwarding bank, when it receives the check from its depositor, gives credit to him at once.* * * * *A bank to which a cash letter comes gives credit to the forwarding bank* for the entire amount of the letter *immediately upon receipt of the letter. If any item thereafter is uncollected or unpaid, a charge back may be made* of the amount thereof *within a given time, the time being prescribed by contract, statute, or rule of a clearing house.* In case of a cash letter, *the collecting* or intermediate bank *does not give advice* to the forwarding bank *of collection but only of rejection.* A cash letter contains no instruction on how to remit the funds when collected, *and the forwarding bank assumes collection unless advised of rejection.*
>
> "*In the case of a collection letter* covering checks, *the forwarding bank does not, upon receipt of such check by it, give credit to the depositor or to the bank from which the item comes.* * * * The collection letter contains instructions on (a) how to remit the funds, when collected, to the forwarding bank, and (b) on how to advise the forwarder of collection. * * * Items covered by collection letters do not go through clearing houses. Items covered by cash letters may. *In the case of a collection letter the forwarding bank does not assume collection until advised thereof.*"

The bulk of bank collections is handled by cash letter. But where doubt is entertained that the paper is good, collection

letters are used.[9] Their use means a different contractual arrangement. Where cash letters are used, the items are regarded as paid unless advice of rejection is given within a specified time. Where collection letters are used, the items are treated as unpaid, until the funds are transmitted or advice of payment is received and acted on.

The Practice of Defendant with Respect to Plaintiff.

The uniform practice covering items forwarded by defendant to plaintiff on collection letters was this: A charge to plaintiff's account was never made until after written advice of credit was actually received or, in exceptional cases, until advice was received by telegraph or telephone. But advice *had* to be received in some form. Defendant's "trouble-shooter" (R. 175) testified (R. 181):

> "With respect to charges against the account of Merchandise Bank resulting from alleged collections sent on to Merchandise Bank it had always been the uniform practice * * * that no charge would be made against the account of the

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[9]Munn's Encyclopedia of Banking and Finance contains the following:

"Letters":—"Letters are of two sorts—cash and collection. Cash letters are those for which the depositor receives credit for the amount of the total footing upon receipt. * * *"

"Collection letter":—"A letter of transmittal * * * accompanying a collection item, i.e. one to be credited to the sender's account only if and when collected. * * *"

"Collection items":—"Checks, drafts * * * deposited with a bank for credit only if and when collection and payment is made, as distinguished from cash items (q.v.), which are credited to the customer's account upon receipt, but which are subject to cancellation in case of non-payment. Most items deposited are cash items. Collection items are those where some doubt is entertained by the depositor of their eventual payment, and they are therefore accorded individual treatment * * *."

Defendant's brief (p. 19) refers to a conversation between LeRoy of plaintiff and Duncan of defendant about certain checks (not those here involved) sent by plaintiff to defendant. These were sent by cash letter (R. 1171).

> Merchandise Bank unless * * * a written paper of some kind constituting an authorization to make the entry, had been received from Merchandise Bank."[10]

Defendant's branch manager testified (R. 352):

> "that it was not the custom or practice of [the] branch in [its] dealings with Merchandise National Bank to instruct the head office to charge Merchandise's account until a written authority to do that was in hand received from Merchandise," that *"we will never pass entry until we have an advice of credit"* and that we "have to have something to support any entry of that sort, and it was always the practice to wait until some written instruction was received from Merchandise on collection items before passing credit to the customer and instructing the head office to charge Merchandise."

Other Evidence.

Other important evidence supporting the finding consists of (1) defendant's contemporaneous conduct and (2) its contract with its customer "Lofendo". Since presentation of these matters involves citation of cases and statutes, we defer it to the argument (pp. 57-59, 83-85, infra), where we also consider the meager evidence on which defendant relies.

4. THE FOUR CHECKS FOR $89,813.10.

The second improper charge made by defendant against plaintiff's deposit account was that for $89,813.10 (p. 3, supra). The facts are covered by Findings XXV-XXVIII, inclusive (R. 108-111).

On November 6, 1948 United Produce drew 4 checks aggregating this sum on its account with plaintiff payable to itself under the name "Lofendo". Defendant's branch received them on November 10th, the day it reiterated its imperative instruction that no "Lofendo" items were to be received except for collection.

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[10]Similar testimony of the same witness appears at R. 197.

Having regard for these instructions, its employees gave no credit on the checks, received them as agent for collection only, and sent them to plaintiff under a collection letter.

Plaintiff received the collection letter on November 12th. The same fraudulent state of affairs existed then as on November 15th when the 6 checks for $113,216.50 arrived, and, misled by the fraud, plaintiff's employees mailed to defendant an advice of credit for $89,813.10 (Finding XXV, R. 108, 109).

Defendant received this advice of credit on November 16, 1948. *But it did not act on it until after the telephone conversation with Mr. Messenger on November 17th and the conversations with Mr. LeRoy on November 18th. And defendant never paid out one cent to anyone nor ever changed its position in reliance on it.*

The court found (Finding XXV, R. 109-110):

> "that defendant did not at any time * * * change its position in any way to its detriment in reliance upon said advice of credit; that the said advice of credit had been received by the defendant on November 16, 1948, but it was not acted upon until November 18, 1948, and then only in the circumstances found below in Paragraphs XXVI, XXVII and XXVIII."

And also (Finding XXVII, R. 110, 111):

> "three days later, on November 19, 1948, defendant charged the sum of $89,813.10 against plaintiff's deposit account with it, and on November 18, 1948, it entered a credit to the 'Lofendo account' for $89,813.10; that defendant predated the charge against plaintiff's account as of November 18, 1948, and it predated the credit to the 'Lofendo account' as of November 17, 1948."

Reason for Defendant's Conduct.

The circumstances in which defendant sought to take advantage of the advice of credit for $89,813.10 are similar to those in

which defendant sought to take advantage of the advice of credit for the $113,216.50, and its action was equally crass.

We have seen how defendant carelessly gave immediate credit to the Lofendo account on November 16 for $97,207 worth of checks received for deposit and honored checks drawn on that account for over $109,000, thereby sustaining a loss of over $96,000.

Almost simultaneously defendant honored another 3 checks totalling $75,586.86 drawn on the account, and thus sustained a loss in that amount as well. These 3 checks arrived at defendant's branch on November 15th under cover of cash letters[11] (Finding XXVII, R. 110). There were insufficient funds in the account to pay these checks. Nevertheless, as defendant admits (Br. 40) and as the court found, the defendant was out-of-pocket on these checks prior to November 17th (R. 111).

As the parties stipulated, when checks are sent by "cash letter" the forwarding bank takes an immediate credit and the receiving bank an immediate charge, quite different from what is done with checks sent by collection letter (see p. 14, supra). As checks sent under cover of cash letters pass through a clearing house, the charges and credits are there made at once. The receiving bank, in a cash letter case, may charge back the items, provided it does so within a time prescribed by contract, clearing house rules or statute. It is admitted that the time for charge-back, in the case of the checks for $75,586.86, expired on November 16th. The time was permitted to elapse by defendant's negligence, sheer oversight of the fact that the checks were "kicking around" the bank (see pp. 25-26, infra). And so defendant then sustained its loss.

Defendant's officers did not know these facts until late on November 18th (see p. 11, supra). The advice of credit for the $89,813.10 reached defendant on November 16th *after* it had

[11]The checks arrived in the "in-clearings" (R. 1181), i.e., through the clearing house (e.g., R. 960). Since only cash letter items come through clearing houses (p. 14, supra), these were cash letter items, as found.

paid out the $109,000 (Finding XXVII, R. 110), the last sum ever paid by it against the "Lofendo" account.[12]

There Is No Element of Estoppel on This Item Either.

As the court found:

> "before *anything was done* by the defendant on the basis of said advice of credit for $89,813.10, plaintiff had communicated with defendant on November 17, 1948 * * * and again on November 18th * * * and the plaintiff on both occasions informed the defendant that United Produce Company had defrauded the plaintiff of a large sum of money exceeding $500,000 and had done so by means of fictitious and fraudulent checks drawn on the 'Lofendo account'; that *consequently, defendant never became a bona fide purchaser for value of the $89,813.10 or any part thereof;*" (Finding XXVIII, R. 111; and see Finding XV, R. 103).

On November 19th defendant charged the sum of $89,813.10 against plaintiff's deposit account, preceding this by a credit of the same amount to the "Lofendo" account. As found (Finding XXVII, R. 111):

> "until that credit was so entered, there were not sufficient funds in the 'Lofendo account' against which to charge the checks for $75,586.86 which had *theretofore* been paid, and the purpose of making the entry was to supply funds against which to make the charge; that thereupon the checks for $75,586.86 were charged against the credit so created in the account."

Thus defendant never acted to its detriment in reliance on the advice of credit for $89,813.10. Its charge of that sum against plaintiff's account and concurrent credit to the "Lofendo" account was an effort to reimburse itself for losses *already* incurred

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[12]Defendant's brief (p. 41) states that it had until the end of November 17th to pay the $109,000. But in fact those checks were immediately paid on November 16th and charged against the account as of November 15th (Stipulated, R. 1182).

through its own negligence and as a result of violation of its own instructions, i.e., the $75,586.86 and part of the $109,000. Neither of these payments had been made in reliance on the advice of credit or in any supposition that the $89,813.10 of checks had been collected.

And when defendant finally attempted to charge plaintiff's account, it was already on notice that United Produce and Lofendo as a participant had defrauded plaintiff out of more than one half million dollars.

Trial Court's Conclusion as to the $89,813.10.

The trial court concluded:

> "That after the 17th day of November, 1948, defendant had no authority or right to pay to 'Lofendo' or itself, in discharge of any obligation of 'Lofendo' to it, the sum of $89,813.10" (Conclusion VIII, R. 115).

The Evidence Supports These Findings.

Defendant realizes that its case as respects the $89,813.10 vanishes unless it can upset the findings. The elementary legal principle is discussed at pages 65 et seq., infra. And because of this realization, defendant tries to juggle events so as to place its action on the advice of credit for $89,813.10 at a moment of time earlier than the Messenger-Estribou telephone conversation of November 17th (e.g., Br. 43-57).

The sole question is: Are the findings supported by the evidence? And the answer is clearly so.

The charge of the $89,813.10 appears in plaintiff's account on defendant's books under date of November 18th (P. Ex. 1),[13] and under defendant's system of bookkeeping (R. 609) this means that the charge was not made until the 19th. The court's finding to that effect is therefore supported.

Defendant asserts (Br. 43) that the sum of $89,813.10 was credited to the "Lofendo" account on November 17th, instead of

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[13]By order of this Court the printing of this exhibit was not required.

on the 18th as the trial court found. But on the afternoon of November 18th Mr. LeRoy, plaintiff's executive vice president, was in the office of Mr. Duncan, the defendant's authorized officer (R. 447, 451). LeRoy testified that in his presence Duncan then telephoned to Estribou, defendant's branch manager, and reported back to LeRoy that *the situation was the same as the day before, i.e., that the balance in the Lofendo account was still only $690* (R. 455). The trial court believed Mr. LeRoy, and this evidence means, of course, that the $89,813.10 had even then not yet been credited to the "Lofendo account", for the ledger sheet of the Lofendo acount shows that when that sum was credited it increased the balance from the $699.02 which had been the balance for several days (D. Ex. 2).

In an effort to defer the moment of the Estribou-Messenger telephone conversation, defendant cites Estribou's testimony that the branch's collection department was closed at the time, and so he could not tell Messenger definitely whether the advice of credit for the 6 checks had been received (Br. 62). But Messenger's testimony was that Estribou called for his records (R. 221, 247) and, with them before him, made a positive statement that the advice of credit had not arrived (R. 223). The trial court believed Messenger.

Recognizing that the making of the various book entries occurred *after* it was on notice, defendant next tries to sever the *book entries,* by which charges and credits are made, from what it calls "the banking operations" (Br. 62). But the trial court found against the defendant, not only as to the time of the entries, but also as to the time of anything that might be called "banking operations" on the subject (Finding XXVII and XXVIII, R. 110, 111). It found that "before *anything* was done by defendant * * * on the basis of said advice of credit," it was on notice (p. 19, supra). The evidence already related supports these findings.

Next defendant assails the finding that on November 17th and 18th plaintiff informed it that United had defrauded it of a large sum of money exceeding $500,000 and had done so by means of fictitious and fraudulent checks drawn on the Lofendo account (Br. 58).

When Messenger telephoned to Estribou on November 17th he not only said that United had defrauded plaintiff of a large sum of money, he did something *much more striking*. He read to Estribou a list of the checks drawn on the "Lofendo" account which plaintiff had sent to defendant for payment since November 4th, and he asked if these checks had been paid. Mr. Estribou examined his own records and gave Mr. Messenger information showing that over $500,000 of them had not been paid. He also said that the account had in it only $690 (R. 221-224). That meant that the $500,000 of checks were worthless paper. Those checks had been sent to defendant by "cash letter" (R. 1171, 1172). This meant that plaintiff had already given United credit on them (see p. 14, supra; also R. 229).

On the next day, November 18th, plaintiff's officer, LeRoy, explained the situation even more fully to defendant. He told it that the fraud was worked largely by means of a group of fictitious checks drawn on the Lofendo account (R. 450) *upon which plaintiff had given credit to United Produce* (R. 449, 450). He showed defendant the list of the items (R. 451). He too did something *more striking*. At defendant's request (R. 454) he wrote it a letter in its offices (P. Ex. 10, R. 1171, 1176) listing the checks, which totalled several hundred thousand dollars. The letter showed that about $500,000 of the checks had been received by the plaintiff from United Produce prior to November 12th.[14]

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[14]Cf. Finding IX, R. 99: "between November 4th and November 12, 1948, plaintiff received from United Produce Company over $500,000 of checks drawn by United Produce Company on its 'Lofendo account'."

On the same day, November 18th, Mr. LeRoy and defendant's Mr. Duncan located many of the checks in the defendant's Central Transit Office, en route to the Bakersfield branch (R. 453). Defendant's authorized officer thus saw their dates. Furthermore, LeRoy told defendant that "Lofendo was a participant in the fraud" (Testimony of defendant's witness Johnson, R. 698).

This all adds up to a picture that must have been obvious to the most reluctant intelligence: the credit balance on November 12th in United's account with plaintiff, on the basis of which the advice of credit was mistakenly sent out that day, was a "phony," created by the allowance of credits based on checks drawn on defendant which defendant knew to be worthless.

Surreptitiousness of Defendant's Conduct.

The very surreptitiousness and secretiveness of defendant's conduct supports the findings.

In the Messenger-Estribou telephone conversation of November 17th, Estribou told Messenger not only that the $113,216.50 advice of credit had not been received, but also that only two collections sent to plaintiff by defendant's branch were still outstanding, one the $113,216.50 item and the other for $52,379 (R. 310, 400, 401). These statements necessarily conveyed the idea that defendant had already received the $89,813.10 advice of credit.[15] Estribou further told Messenger that the Lofendo account had a balance of only $699.02, and that defendant had been paying only against collected funds (R. 224).

If the balance was only $699.02 after crediting $89,813.10, and if defendant had been paying out only against collected funds, it would appear that defendant had already paid out funds and changed its position in reliance on the $89,813.10 advice of credit. Mr. Messenger made this assumption, and consequently

[15]The $89,813.10 collection letter was dated November 10th, the $113,216.50 letter November 13th, and the $52,379 letter November 15th (R. 1182).

plaintiff did not mention this advice of credit then or in the conversations of November 18th (R. 312).[16]

As the court found (Finding XXV, p. 109):

> "on November 17, 1948, when the plaintiff telephoned to the defendant as found in Paragraph XIV above, defendant stated to plaintiff that only two collection letters theretofore sent by defendant's branch to the plaintiff were outstanding; one for the $113,216.50 and a later one for $52,379.00, and that there was a balance of only $699.02 in the 'Lofendo account'; that plaintiff reasonably assumed from this statement that the advice of credit for $89,813.10 had already been received and acted upon by the defendant and that in reliance thereon the defendant had changed its position; that consequently, neither then or on November 18, 1948, did plaintiff speak or write to defendant relative to the $89,813.10;"

The finding adds:

> "but in fact, at the time of said telephone conversation the advice of credit for $89,813.10 had not yet been acted upon by defendant in any way whatsoever;"

As we have already seen, late on November 18th defendant learned of its own employees' negligence. It then decided to violate its agreement about not charging plaintiff's account with the $113,216.50. It is evident that it also decided to charge the $89,813.10. But it concealed from plaintiff the fact that it had not already done so. During preparation for trial, plaintiff's counsel took depositions of defendant's officers and learned of a report of an investigation made by its Cashier's Department. But defendant refused to produce the document under a claim of privilege (R. 73). After repeated demands, defendant finally produced the document near the close of the trial (R. 75-79). And thus the truth came out.

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[16]Before telephoning, Mr. Messenger had been told by plaintiff's general counsel that an advice of credit could be revoked if not yet acted on (R. 257).

As the trial court found (Finding XXVIII, R. 111):

> "not until the trial of this cause did plaintiff discover that defendant was not a bona fide purchaser for value of said sum and that it had never changed its position to its detriment in reliance on said advice of credit for $89,813.10."

The complaint was amended accordingly to conform to the proof (R. 61, 821, 827).[17]

The reason for the concealment is obvious. Defendant knew that if the fact came out, plaintiff would seek recovery of the sum of $89,813.10 as well as of the sum of $113,216.50.[18]

Negligence of Defendant's Conduct.

Defendant was negligent in honoring the checks for $75,586.86 drawn on the Lofendo account, just as it was in honoring the checks for $109,000. The fact that defendant was negligent is no affirmative part of plaintiff's case. But it answers defendant's attempt to impose on plaintiff the loss defendant sustained.

When the 3 checks for $75,586.86 arrived under cover of cash letters on November 15th, "there were not sufficient funds in the account to pay them, but defendant's employees negligently failed to reject the checks" (Finding XXVI, R. 110). The next day, defendant gave an immediate credit to the "Lofendo" account for checks totalling $97,207, already discussed (p. 11, supra). Had the $75,586.86 then been charged against the account, the apparent credit balance created by the credit for $97,207 would have been so reduced that there would have been no balance, even apparent, against which to honor the checks for $109,569.15, which arrived the very same day, as already noted (p. 11, supra). But defendant "failed to charge the checks for $75,586.86 against

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[17]Defendant moved to strike the amendment, the motion was denied when the case was decided (R. 95), and defendant assigns no error relative thereto.

[18]When plaintiff's counsel rose during the trial and announced that he wished to amend the complaint to conform to the proof, and before he had stated what the amendment was to be, defendant's counsel remarked, "Here comes the eighty-nine thousand" (R. 70, admitted, R. 89).

the 'Lofendo account' and permitted them to continue to lie around its branch" (Finding XXVI, R. 110).[19] It paid the $75,586.86 without noting the fact on the *Lofendo* ledger sheet, and defendant then paid out the $109,000 against the account as well.

ANALYSIS OF THE CASE: THE ISSUES STATED; SUMMARY OF ARGUMENT

Because banking transactions involve many entries and papers, they tend to seem complicated. Defendant has sought to capitalize on this apparent complication. But, just as the findings show the facts to be simple, a preliminary analysis will do the same for the issues.

This Is a Suit on Plaintiff's Account with Defendant, Not on any Checks.

Contrary to defendant's repeated assertion (e.g., Br. 2, 56), this is *not* a suit upon the 6 checks for $113,216.50 or the 4 checks for $89,813.10.

Plaintiff was a depositor with defendant, and this is an action to recover the funds deposited. Plaintiff being a depositor, defendant was its debtor. And payment being an affirmative defense, it was incumbent on defendant to prove that it had paid plaintiff what it owed.[20]

The checks enter the case only because defendant brings them in as the basis of an alleged defense of payment—as the excuse

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[19]It was stipulated (R. 1183) that the credit of $97,207 "created an apparent balance * * * against which * * * the $75,586.86 * * * could have been charged, but for some reason which the defendant was unable to explain, they were not." The explanation is obvious enough. Defendant's employees on November 15th had listed the $75,586.86 of checks for rejection but then proceeded to overlook them for several days (R. 1183).

[20]This is California law, *Lloyd v. Kleefisch,* 48 C.A.2d 408, 416, 120 Pac.2d 97; *Hansen v. Bear Film Co.,* 28 Cal.2d 154, 181, 168 Pac.2d 946. The rule applies in the federal court in a diversity case, 2 *Moore's Federal Practice,* 2d ed. pp. 1687-1691; *Person v. United States,* 112 F.2d 1 (8 Cir.), cer. den. 311 U.S. 672.

for its unconscionable refusal to pay plaintiff the full balance in the account. Defendant seized that balance in order to make itself whole *for a loss of its own.* That loss was sustained when defendant's employees honored two groups of checks drawn on the Lofendo account aggregating about $185,000 against a balance of only $13,000 (R. 1181). And those checks were totally unrelated to the 6 checks or the 4 checks (see pp. 10-12, 18-19, supra).

No One Ever Suffered a Loss by Reason of the 6 Checks for $113,216.50 or the 4 Checks for $89,813.10.

Repeatedly defendant speaks of a "loss" suffered by reason of the 6 checks and the 4 checks, and it poses the question as being who should suffer this "loss" (e.g., pp. 5, 11, 89).

But there is no such loss. No funds were paid out to anyone either by defendant or plaintiff upon these checks or by reason of them (pp. 12, 17, supra).[21] The trial court found (Finding XXIX, R. 112):

> "that it is not true that the defendant, or plaintiff, or anyone else, has ever suffered any loss by reason of the 6 checks for $113,216.50";

The court continued by finding (R. 112):

> "that the plaintiff has been damaged by reason of defendant's refusal to pay to plaintiff the balance in plaintiff's account with defendant, and one of defendant's reasons for refusing to pay to plaintiff the amount of the balance was that defendant was entitled to charge the sum of $113,216.50 against plaintiff's account; but no one has suffered any loss by reason of the 6 checks for $113,216.50, since the defendant paid out no funds and did not act in any way to its detriment in reliance on said 6 checks or anything connected therewith;"[22]

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[21]As said in another case, "It will be observed from the recitation of the peregrinations of this check that it produced much bookkeeping, but no cash." *Lincoln County v. Gibson,* 255 Pac. 119, 120 (Wash.).

[22]The findings as to the 4 checks for $89,813.10 are similar (see pp. 17, 19, supra).

Stating that plaintiff has sustained a loss at the hands of United Produce in excess of $500,000, defendant asserts that the judgment permits the plaintiff to recover $203,047 of this amount from defendant (e.g., Br. 15).

This is not so. On the contrary, defendant simply tries to use the checks as a tool to palm off its loss onto the plaintiff. Plaintiff did suffer that loss, but it is quite apart from the checks here involved. Defendant also suffered a loss at the hands of the same swindler. Each of the two banks was defrauded by the same party, and the 6 checks and the 4 checks have nothing to do with the loss of either.

The fallacious assumption about a "loss" underlies a variety of defendant's arguments, e.g., the whole of its argument about plaintiff's alleged negligence.

The Advice of Credit Passes Out of the Case.

Plaintiff's deposit account with defendant was like the deposit account of any other customer. A debtor bank has no right to deduct anything from the amount owed its depositor, its creditor, unless it has an order from the customer authorizing it to do so, or unless the creditor becomes legally indebted to the debtor so as to permit an offset.

Certainly the plaintiff never authorized the defendant to charge its account with $113,216.50. The "advice of credit" was no such authorization, because it was revoked before its receipt by defendant. An order revoked before acted on is no order at all.

For example, plaintiff could have torn it up before mailing, or could have procured it back from the post office before its delivery to the defendant. If these things had happened, the advice would have been ineffective to alter anyone's rights. It is so held in *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717, in the oft-cited case of *Guardian National Bank v. Huntington County State Bank,* 187 N.E. 388, 206 Ind. 185, and the recent case of

Bohlig v. First National Bank, 48 N.W.2d 445 (Minn. 1951).

The advice of credit is therefore as irrelevant as if it had never come into being.

The trial court correctly concluded:

> "That the rescinded and cancelled advice of credit is not and cannot be the basis for credit, claim, charge or set-off by defendant against plaintiff" (Conclusion IV, R. 114).

Again:

> "That defendant never acted to its detriment in reliance upon the rescinded and cancelled advice of credit" (Conclusion V, R. 114).

Defendant does not seriously contend otherwise.[23]

While the advice of credit for the $89,813.10 was received by defendant, it did not act upon it before notice of the fraud. Thereafter, as we shall show, at pages 64-78, infra, it had no right to act on it.

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[23]It does make a passing argument (at pp. 70-71) that the advice of credit was "delivered," citing *People v. LaRue,* 28 C.A.2d 748. That case involved venue in a criminal charge, under Cal. Penal Code, Sec. 476(a), of "uttering and delivering" a check by mailing to a creditor in payment of a purchase. The court held that deposit of a negotiable instrument in the post office addressed to a payee constitutes "uttering and delivering," absent anything indicating that the carrier of the letter is the sender's agent.

The "advice of credit" was not a negotiable instrument—it was a mere order to the debtor bank to charge the account of the creditor depositor. In another context defendant cites 9 C.J.S. 502, but fails to note this statement:

> "The fact that the drawee bank deposits in the mail a cash letter giving credit to the payee bank does not create a payment where the letter is subsequently withdrawn from the mail, since the post-office may be regarded as an agent of the sender so long as the communication may be withdrawn by it, and intrusting a letter of credit, or actual funds, to an agent does not constitute payment until delivery of the letter of credit or funds, and for this purpose it is immaterial whether the transaction constitutes mere payment or the acceptance of an offer."

There Is No Element of Estoppel Against Plaintiff.

It is next to be emphasized that no element of estoppel exists against plaintiff. The defendant knew nothing about the advice of credit until its revocation, nothing of the perforation of the checks until it received them back on November 22, 1948 (R. 102, 1179) already bearing the notation "Cancelled in error," and nothing of the Chicago bookkeeping entries until after this lawsuit was started. Although it inferred that those entries had occurred when it heard that an advice of credit had been sent out in error (R. 351), it was then simultaneously placed on notice. *And, of course, it never paid out a penny or changed its position in reliance on any of these things.*

The trial court so found and concluded that there was no estoppel (pp. 10, 12, 19, supra).

At various places defendant asserts that its "position was changed by the Merchandise's payment of the checks" (e.g., Br. 105) or that it will be "prejudiced" by plaintiff's recovery (e.g., Br. 103, 104, 107). Such statements are Vyshinsky English: the words are used in a private sense as the end product of involved arguments. Defendant merely means that when it pays the judgment it will have that much less money. It cannot mean that anything plaintiff did relative to the 6 checks or the 4 checks has imposed loss on it or led it to change its position.

The Question Is Whether Defendant Could Have Sued Plaintiff for the $113,216.50 and the $89,813.10.

Defendant assumes that this case turns on a determination of what type of acts constitutes "payment" of checks by a bank to which they are sent for collection. And it would make that determination by applying—not a common sense rule—but an artificial and mechanical concept of the effect of the bookkeeping entries in Chicago.

But, of course, to use the term "payment" is Pickwickian. The existence of plaintiff's deposit account with defendant afforded

defendant an opportunity to try, by extra-legal means, to assert that plaintiff had become indebted to it. If there had been no such account, defendant would have had to sue plaintiff, if it wished to assert its claim. And its claim really is that plaintiff was obligated to pay it, not that it had paid. It follows that the question comes to this: Did the mere bookkeeping entries in Chicago and the perforation of the checks create an indebtedness *of plaintiff* for their sum? If so, did they create such an indebtedness *to defendant?* And if so, did they do so beyond revocation?

Advancing one step further, the question must come to this: could the defendant, Bank of America, have sued the plaintiff for $113,216.50 or for $89,813.10?

Summary of the Discussion to Follow on This Question.

We shall demonstrate that there was no "collection" or "payment" of the checks (pp. 78-99, infra). But that question need not be reached because there are three other answers, each complete and independent:

1. Since defendant took the checks for collection only and gave no credit on them to anyone, not even provisional, it never became a holder of the checks, much less a holder in due course. It was only an agent of "Lofendo" for collection.

Under the so-called "Massachusetts rule," which prevails in both California and Illinois, plaintiff too was "Lofendo's" agent for collection, and it was neither an agent of defendant nor defendant's debtor relative to these checks. Under this rule, the forwarding bank (defendant) has no claim against the collecting bank (plaintiff).

Consequently, defendant has no standing to assert that there was collection or payment, for it may not substitute itself as a creditor in the payee's place; it may not seek to offset a debt allegedly owed by plaintiff to defendant's principal "Lofendo" against a debt owed by defendant itself to the plaintiff. (See discussion, pp. 36 to 40, infra.)

2. If defendant did have a standing to assert that the checks had been paid, its rights could be no greater than those of United Produce Company. But the latter has no rights against plaintiff under any rule, however mechanical. "Lofendo" was United Produce Company, and it is universally held that when a payee [Lofendo] and the drawer [United Produce] are the same, it can acquire no rights against the drawee bank as the result of a check drawn against insufficient funds or as part of a fraud worked by the drawer.

The identity of Lofendo and United Produce washes away a variety of defendant's arguments, which concern the rights of innocent payees. In view of its fraud on plaintiff and the lack of funds in its account in Chicago, United Produce never had any rights against plaintiff by reason of the 6 checks or 4 checks.

The only way defendant could acquire any rights at all against plaintiff by reason of the checks was through "Lofendo," i.e., United Produce. And so the essence of its case is that, somehow, it secured through the defrauder United Produce greater rights against plaintiff than United Produce itself would have, to compel payment of the checks.

One can obtain greater rights in checks than the payee in two ways only: (1) by becoming a holder in due course or purchaser for value before notice or (2) by operation of estoppel. Here defendant was not a holder at all. Nor was there an estoppel, because defendant never paid money or changed its position in reliance on the checks or on an assumption that they were collected.

Although defendant tries to assert a "better right" than Lofendo by an argument about acquiring a "lien" on the checks, it never had a lien, and it finally so admits.

Defendant also tries to assert a "better right" by arguing that plaintiff's internal bookkeeping in Chicago automatically transmuted plaintiff's relationship from that of agent for "Lofendo" into that of debtor to defendant, and likewise converted defend-

ant's agency for "Lofendo" into a debt to him. No such transmutation occurred; but even if it did, defendant's conclusion would not follow. A change in relationship could only arise from a contract between plaintiff and defendant, whereby plaintiff promised to pay the sums to defendant in consideration of defendant's promise to assume plaintiff's alleged obligation to the payee. But there was no consideration for such a contract, since plaintiff had no obligation to the payee, the latter being identical with the defrauder United Produce.

Moreover, defendant's contract with "Lofendo," whereby it undertook collection of the checks, precluded any obligation by it to him from arising merely upon book entries in Chicago or upon anything short of defendant's obtaining good funds in hand.

Furthermore, any supposed contract whereby plaintiff promised to pay defendant on defendant's promise to pay "Lofendo" was rescinded by the agreement entered into between plaintiff and defendant on November 17 and 18, 1948, as found by the trial court. (See discussion at pp. 41-65.)

3. Even if there were "payment," the plaintiff is entitled to revoke and recover. In this connection we shall note that the factual difference between the events surrounding the $89,813.10 and the $113,216.50 is not relevant.

Plaintiff's right is clear under California law, which controls this question. If payment had been made directly to "Lofendo," i.e., United Produce, plaintiff could recover in view of United's fraud. Where payment has been made to an agent in circumstances in which it could be recovered from the principal if made directly to him, it can be recovered from the agent unless the latter has, before notice of the fraud, paid the money over to or for his principal. Nor may an agent apply the money on debts due himself from the principal after such notice. Cf. *Weiner v. Roof,* 19 Cal.2d 748. The trial court found that defendant did nothing until after such notice.

Defendant tenders almost no answer relative to the $113,216.50, and its answer relative to the $89,813.10 is largely a quarrel with the findings, which are amply supported. (See discussion, pp. 65-78, infra.)

Summary of the Discussion re "Payment."

In fact, the mere bookkeeping entries in Chicago were not "payment." Defendant's entire argument is vitiated by the major fallacy of ignoring the facts of this case as to the nature of the collection contract.

Collection arrangements are contractual, between holder of the check, forwarding bank and collecting bank. Every cited case turns on the contract proved and found. Here the trial court found that, under the contract, collection and payment of checks sent by defendant to plaintiff were consummated only by a charge made against plaintiff's account on defendant's books in San Francisco pursuant to an outstanding authorization to make it. And nothing short of that could change the relationship of the parties whereby both plaintiff and defendant were merely the payee's agent.

This finding is supported by an overwhelming mass of evidence, including settled custom and usage, the course of dealing and practice between the parties, contemporanous construction by conduct, the contract between "Lofendo" and defendant. And one of the major facts is that the collections were carried on under "collection letters" and not "cash letters."

Defendant's citations are not in point because they involve different contractual arrangements; e.g., they are "cash letter" cases. In citing them defendant ignores the stipulated difference between cash letters and collection letters and the significance of the two.

Defendant's arguments also confound the different senses in which "payment" is used. For example, from the standpoint of a maker's right against the drawee bank to stop payment or from

the standpoint of one depositing with a bank a check drawn upon it, a check may be paid. But from the standpoint of transmission of funds by a collecting bank to a forwarding bank, the tests are different.

A third fallacy lies in citing cases involving the rights of holders in due course, or not involving fraud or mistake. A fourth fallacy lies in citing cases from jurisdictions which proceed on basic assumptions of law contrary to those prevailing in California and Illinois.

Defendant's Charges of Negligence and Misrepresentation on Plaintiff's Part Constitute No Defenses but Mere Assertions of Counterclaims.

A quarter of defendant's brief is devoted to charges of negligence and misrepresentations on plaintiff's part (Br. 72-107). While defendant speaks of these matters as a defense to the complaint, they have nothing to do with a defense; they are affirmative counterclaims for the recovery of defendant's own loss. The slightest reflection so demonstrates. If the 6 checks for $113,216.50 or the 4 checks for $89,813.10, all drawn on plaintiff bank, had *never* existed, defendant would still have sustained *its* loss, and its claim against the plaintiff therefor would be neither better nor worse than it is now.

Its loss resulted from honoring checks drawn on itself. And payment thereof was in no way made in reliance on the 6 checks or the 4 checks (p. 27, supra), nor, as found, was it caused in any way by or in reliance on anything plaintiff did or failed to do.

We discuss these matters at the end of this brief (pp. 99 to 115).

DISCUSSION

I.

Defendant Has No Standing to Assert That the Checks Were Collected. It Is Not a Real Party in Interest to Assert the Claim.

As said in 8 Zollman on Banks and Banking, p. 116, in determining "the liability of the various banks in a chain of collection",

> "It is * * * important to discover the precise relation of the bank to the check, whether owner or merely collecting agent."

Defendant's Relation to the Checks:—It was Never the Owner but Only United Produce's Agent.

A bank may take paper in three ways: (a) it may discount, i.e., buy, the paper for cash or credit. In that event it becomes the owner. (b) It may give a credit but by agreement make the credit conditional and take the paper for collection. In that event it does not become a holder in due course until and unless the customer draws against the credit before notice to the bank of an infirmity, and then only to the extent that he does so.[1] In the meanwhile it is only an agent for collection. (c) Or it may give no credit at all, not even provisional, in which event it is solely an agent of the owner.

If it takes a check for collection, passing no credit to the account of its customer, it acquires no title to the check and has no beneficial interest. It does not become the customer's debtor but only his agent.

Since defendant concedes that this is the law (Br. 29, 30), we need not dwell on the authorities.[2]

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[1]Annotation, 80 A.L.R. 1064; *Bath National Bank v. Sonnenstrahl,* 164 N.E. 327, 249 N.Y. 391; *Pacific Acceptance Corp. v. Goodman,* 72 C.A. 143, 236 Pac. 964.

[2]The rule is stated in *National Bank of New Zealand v. Finn,* 81 Cal. App. 317, 336, 253 Pac. 757, citing 3 R.C.L. 633. So also, *Grower's Marketing Service v. Webster & Atlas National Bank,* 62 N.E.2d 225, 318 Mass. 496; 8 *Zollman on Banks and Banking,* pp. 351, 354-356, 371, Sec. 5601; 6 *Michie, Banks and Banking,* p. 4.

This was the situation here with respect to the 6 checks for $113,216.50 and the 4 checks for $89,813.10. Defendant took the checks for collection only; no credit whatever was given, much less drawn against (see pp. 7, 12, 17, supra).

A fortiori, the bank did not become a holder in due course, for it did not become a holder at all.

The payee or holder of the checks was "Lofendo", i.e., United Produce (p. 4, supra). In short, defendant was merely an agent of United Produce to collect the checks. Defendant so admits (Br. 29).

Defendant's Relationship to Plaintiff as Respects the Checks: Both Were the Payee's Agents.

The trial court concluded:

> "That plaintiff and defendant were the agents of 'Lofendo' in effecting collection of the checks forwarded for collection" (Conclusion II, R. 114).

There are two different rules regarding the relationship of forwarding bank and collecting bank in collections, the "New York rule" and the "Massachusetts rule". Under the New York rule the bank to which the paper is sent, the collecting bank, is the agent of the forwarding bank. Under the Massachusetts rule no relationship at all exists between the two banks. The collecting bank, as well as the forwarding bank, is the agent of the owner of the paper. 8 *Zollman on Banks and Banking,* p. 114.[3]

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[3]There used to be a "federal rule," similar to the New York rule, but since *Erie Railroad Company v. Tompkins,* 304 U.S. 64, there is no longer such a thing as a federal rule in any field. The recent case of *First Trust & Savings Bank of Oneida v. Kent,* 119 F.2d 151 (6 Cir.) so recognizes in the field of bank collections (p. 155).

Our only reason for mentioning the New York rule is that its existence eliminates the confusion that would otherwise arise from reading many decisions that may be found in the books. As 8 *Zollman on Banks and Banking* says (p. 115):

> "The existence of these two rules explains much of the contrariety which exists as to the liability of the various banks in a chain of col-

Both Illinois[4] and California[5] follow the Massachusetts rule. Defendant so concedes (Br. 29). Plaintiff was "Lofendo's", not defendant's, agent, and there was no relationship whatever between plaintiff and defendant. Each was the agent of "Lofendo", i.e., of United Produce, as the payee and holder of the checks. Thus 8 Zollman, p. 114 states:

> "Under the Massachusetts rule, the initial bank is liable only for the selection of a suitable local agent to whom to intrust the collection and for the transmission of the paper to such agent with proper instructions. Under the New York rule * * * the initial bank becomes an independent contractor. Under the Massachusetts rule, the bank to which the paper is forwarded becomes the agent of the owner."

Defendant Has No Standing to Assert That the Checks Were Collected.

It follows, as Zollman states (p. 126):

> "Under the Massachusetts rule, the forwarding bank, being merely an agent for transmission, clearly has no right of action against the collecting bank."

And so defendant, a mere agent for the owner, has no right of action against the plaintiff, itself an agent for the owner. 8 *Zollman*, p. 123.

Defendant simply has no standing to assert that the checks were "collected" or "paid".

Many cases involve the question what constitutes collection or payment of checks. But in all such cases the claim of payment

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lection both to each other and to the owner in cases of the insolvency or negligence of any of such banks. * * * Either rule, of course, is confined to cases 'where the bank receives the check for collection, not to those in which it becomes the owner of the check and makes the collection on its own account'."

[4]8 *Zollman on Banks and Banking*, p. 118; *Krueger v. First National Bank*, 217 Ill. App. 18.

[5]So conceded in defendant's brief at pp. 29, 30.

is asserted by the payee or holder in due course—not by a bank in a collection chain where that bank has not first given credit and become the owner.

Defendant asserts that the legal consequences of what transpired in Illinois are governed by Illinois law (Br. 18). The Illinois decisions show that defendant has no standing in the premises. In *Krueger v. First National Bank,* 217 Ill. App. 18, the payee of a draft sent it to defendant for collection, which forwarded it to the Auburn Bank. The latter actually collected the money from the drawee but never remitted or reported the fact to defendant. Later defendant indirectly learned the fact and charged a deposit account maintained by the Auburn Bank with it. It turned over to the Auburn's receiver only the balance. The receiver sued for the deducted amount and recovered judgment.

That case and this are similar. The defendants in the two cases occupy similar positions, as do the plaintiffs. Here, as there, the collecting bank happened to have had a deposit account with the forwarding bank. In view of the revocation of the advice of credit and the notice of the fraud, the present case is the same as if plaintiff had not mailed it at all but subsequently, by accident, defendant learned of the Chicago book entries (p. 28, supra). Could defendant then have deducted the $113,216.50 or the $89,813.10 from plaintiff's account? *The Auburn case says no.*

The collecting bank, the court said, is not the agent of the forwarding bank but of the payee. When the collection was effected, the payee and not the forwarding bank became the collecting bank's creditor, and the right of action, if any, against the Auburn bank was in the payee and not in the forwarding bank. By trying to deduct the amount of the draft from Auburn's account, defendant there improperly sought "indirectly to substitute [itself] as a creditor in its [the payee's] place." Any other holding, the court noted, would rest solely on the "irrelevant fact

that the Auburn State Bank had an account with defendant bank and the fortuitous circumstance that its credit balance was in excess of the amount of the draft."

In essence, the question is one of right of set-off. If the collecting bank is a depositor of the forwarding bank, as here, it is the creditor of the forwarding bank. And if the forwarding bank has taken the paper only for collection, as here, it is only the payee's agent. It cannot set off its personal debt to the collecting bank against a debt of the collecting bank to the payee arising from the collection. This is so held in *Dakin v. Bayly*, 290 U. S. 143. There, under a Florida statute similar to the California Bank Act, the "Massachusetts rule" applied, that forwarding bank and collecting bank were both agents of the payee. As here, the collecting bank had an account with the forwarding bank. The court said:

> "The conclusion is that while the Clearwater bank individually owed the receiver of the St. Petersburg bank, the latter did not owe the former, but at best the claim was made as an agent. If this be true, set off may not be allowed, for a defendant sued upon his individual debt may not avail himself for this purpose of a demand against the plaintiff held in a fiduciary capacity" (p. 146).

In *Bosworth, receiver v. Continental Illinois Bank & Trust Co.*, 291 U. S. 643, the Supreme Court, in reliance on the *Bayly* case, reversed a decision of the Seventh Circuit, 65 F.2d 632, arising in Illinois.[6]

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[6]In the *Bosworth* case, the forwarding bank had even given an immediate credit to its depositor. The Supreme Court nevertheless held it to be an agent only. In the present case, defendant had given no credit at all to "Lofendo."

II.

In Order to Prevail Defendant Must Not Only Have a Standing but It Must Have a Better Right in the Checks Than United Produce Since the Latter Has No Rights at All.

In the cases just discussed the collecting bank had actually collected the funds, and there was no fraud perpetrated on it by anyone. Consequently, it was accountable to *someone.* But that someone, it was held, was not the forwarding bank, but the payee. And so defendant is without standing to assert that the checks were collected.

But even if it had a standing, it could prevail only if its rights were better than those of "Lofendo", because "Lofendo" is United Produce (p. 4, supra), and patently United Produce has no rights at all against plaintiff.

A. WHERE PAYEE AND MAKER ARE THE SAME, IT CAN ACQUIRE NO RIGHTS AGAINST THE DRAWEE BANK AS A RESULT OF A CHECK DRAWN AGAINST INSUFFICIENT FUNDS OR AS PART OF A FRAUD.

If the owner of a check is party to the fraud on the drawee bank or knew that the drawer had insufficient funds, he can assert no claim that the check has been paid. We know of no decision contrary to this common-sense rule.

A bank paying a check, drawn on it, to a bona fide holder in the mistaken belief that there were sufficient funds in the account may not recover the payment. Many of defendant's citations hold no more than this.[7] Yet, as pointed out in 9 *C.J.S.* 724, 725,

> "the bank may recover where the holder is not a purchaser for value * * * or where the holder has fraudulently induced the bank to pay * * *."

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[7]E.g., *First National Bank v. Noble,* 179 Ore. 26, 168 Pac.2d 354. There the court held that under the custom of the community giving a cashier's check was equivalent to giving cash (168 Pac.2d 359 (2d col.) 360, 361), and applied the rule that a holder of a check who has paid value in good faith and receives payment from the drawee is under no duty to return the money.

"Where a bank honors and pays a check under a mistake of fact, it may sue for recovery of the money against one receiving payment thereon who is not a bona fide holder for value * * *. If the payee of a check has knowledge that there are no funds on deposit to meet it, and the bank pays the check in ignorance of that fact, there may be a recovery of the payment, or in case a credit has been given the payee on the books of the bank it may be stricken off. * * *

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"Where an improper payment of a check is induced by the holder's fraud or misrepresentation, the bank may recover the amount paid, although the bank's action was negligent as to the drawer."

Similarly, it has been held in "across-the-counter" cases, i.e., cases where one presents a check across the counter to the drawee and instead of taking the cash accepts a credit in his own account at the same bank, that the bank may not cancel the credit merely because the drawer's account had insufficient funds, for the case is similar to receiving the cash and redepositing it.

But even in these cases, as said in *Brady on Bank Checks* (2d ed.), p. 423,

"The holder, however, must act in good faith in order to be entitled to retain the benefit which the law accords him upon depositing a check to his credit in the drawee bank. * * * where the holder of a check deposited it in the drawee bank, knowing that the drawer had no funds there to meet it, the crediting of the check to the holder did not constitute a payment of the check and the depositor could not recover the amount from the bank."

As 9 *C.J.S.*, p. 503, says:

"* * * but if the holder of the check knows that there are not sufficient funds he is guilty of a fraud on the bank, and the collection may be cancelled."

Where the holder of the check and the drawer (maker) are one and the same, the case is even clearer. As 7 *Zollman on Banks and Banking,* p. 444, says:

> "Much less can it be doubted that a recovery lies where the check has actually been paid to the drawer. The money of the bank can in such case be traced into the hands of the drawer, and neither law nor equity demands that the latter should be allowed to retain what he has wrongfully obtained."[8]

Defendant's own citations recognize the fact. Thus, in *Oregon Iron & Steel Co. v. Kelso State Bank,* 129 Wash. 109, 224 Pac. 569, a bank was denied recovery against an innocent payee where it paid against insufficient funds, but the court said that it could recover from the drawer (p. 573). Here payee and drawer were one. Defendant cites a number of other authorities to support its contention that the mere bookkeeping entries in Chicago constituted payment. *But all of them recognize that fraud of the payee would strip such bookkeeping acts of any capability of constituting payment* (see discussion at pages 95-98, infra). For example, *Restatement of Restitution,* Sec. 14, Illustration 8, states that the paying bank may recover where the payee knew that there were insufficient funds behind the check.

Answer to Defendant's Statutory Argument.

The common sense principles just reviewed eliminate an argument that defendant bases on Section 207(a) of the Illinois Negotiable Instruments Act, as it read in 1948. The section is quoted in its brief, page 18, footnote 8.[9]

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[8]Zollman also says (447):
"Where money is fraudulently obtained from a bank on an overdraft, the title thereto remains in the bank, and it may be followed and reclaimed in the hands of any person who has not taken it in good faith and allowed an equivalent therefor; and therefore, where the identical money is deposited in another bank, the defrauded bank may have an injunction restraining the withdrawal of the same."

[9]That section was completely changed in 1949; Laws 1949, p. 1160, Sec. 1.

Defendant asserts that, if a check is not rejected within a specified time, "the check is then deemed to have been paid", under this statute. The section does not so provide. Its meaning is clear when read in context.

Title III (Sections 184 to 189) of the Uniform Negotiable Instruments Law (N.I.L.) deals with "promissory notes and checks." This title constitutes Sections 3265 to 3265(g) of the California Civil Code and Sections 205 to 211 of the Illinois law.[10] Section 207(a) of the Illinois Act was inserted by amendment in 1943 into the Illinois equivalent of Title III.

The last section of the title (Section 189, N.I.L.)[11] provides:

> "A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer of the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check."

Prior to the enactment of the N.I.L., most jurisdictions, including California, held that the payee or holder of a check had no rights whatever against the drawee bank, in the absence of an acceptance. The drawee's duties were to the drawer only, and a check was not an assignment of funds. 9 *C.J.S.* 783. *Dunlap v. Commercial National Bank,* 50 Cal. App. 476, 480, 195 Pac. 688. In these jurisdictions Section 189 was merely declaratory of what was already the law. In a few jurisdictions, such as Illinois, a check was deemed an assignment of the funds, and the payee had the rights of an assignee. In these jurisdictions Section 189 changed the law. *State Bank of Chicago v. Mid-City Bank,* 217 Ill. App. 81; *Independent etc. Assn. v. Fort Dearborn Bank,* 142 N.E. 458, 311 Ill. 278.

The later adoption in Illinois of Section 207(a) was merely a partial restoration of the former rule in that state; that is, if the bank fails to reject a check within the specified time, the lapse of time operates as an acceptance and thus as an assignment from

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[10]Smith-Hurd Ann. St., Ch. 98.

[11]Ill. Act, Smith-Hurd, Ch. 98, Sec. 210; Cal. Civ. Code, Sec. 3265(e).

the drawer to the payee or holder of the drawer's rights as creditor against his bank.

But an assignee has no better rights than an assignor. 6 *C.J.S.* 1155, Sec. 99; *Restatement of Contracts,* Sec. 167.[12]

Where a check is accepted by mistake, the acceptance may be revoked, so long as rights of third parties have not intervened and the holder has not changed his position in reliance thereon. This is true in California, *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717, and Illinois. Thus in *Gillett v. Williamsville State Bank,* 34 N.E.2d 552, 310 Ill. App. 395, one of defendant's citations, the court noted (p. 555, 2d col.), "Where a check has been certified by mistake and the rights of third parties have not intervened, the certification may be revoked."

Most other jurisdictions agree. 9 *C.J.S.* p. 793; 5 *R.C.L.* 527.[13] And all agree that this is so where the acceptance was procured by fraud; and where the acceptance is revocable, the facts making it so are a defense to a suit by the holder against the bank. 9 *C.J.S.* 785, Sec. 367; p. 793, Sec. 376(b).

In short, lapse of time under Section 207(a) would merely create an obligation on the part of the drawee bank to the payee to the same extent as the bank was obliged to the maker to honor his check. It cuts off no defenses against the payee that the bank would have against the drawer if suit were brought by the drawer for dishonor of his check. This is indicated by the only case involving the section, *Rock Finance Co. v. Central Nat. Bank of Sterling,* 89 N.E.2d 828, 336 Ill. App. 319 (1950). A summary judgment had been correctly entered for the drawee in a suit on a check because it was rejected within the prescribed time limit,

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[12]*Restatement of Restitution,* Sec. 172, p. 693, says:
"* * * although an assignee who purchases the assignment for value without notice of equities of third persons takes free of such equities, he takes subject to such defenses as the obligor may have (see Restatement of Contracts, Sec. 167)."

[13]*Irving Bank v. Wetherald,* 36 N.Y. 335; *Carnegie Trust Co. v. First National Bank,* 141 N.Y.S. 745; *Mt. Morris Bank v. Twenty-Third Ward Bank,* 64 N.E. 810 (N.Y.).

provided that the bank had until the end of the day and not merely until the close of the bank at 3 P.M. The court stated (p. 830) that the question was whether failure to reject before 3 P.M. "constituted an implied acceptance of liability thereon." If it did, "the issue of defendant's liability would depend upon other affirmative defenses involving certain questions of fact."

Parties may by contract superimpose upon a statute which makes delay equivalent to acceptance a provision that the acceptance may not be revoked or may be revoked within a limited time (see, e.g., discussion of cash letters at p. 14, supra, and pp. 87 et seq., infra). But nothing like that was present in this case as respects the 6 checks for $113,216.50 or the 4 checks for $89,813.10.

Two conclusions are evident:

1. Since "Lofendo", the payee, and United Produce, the maker, were identical, every defense plaintiff had against United as maker it had against United as payee, despite "acceptance". *Under the facts of this case,* Section 207(a) gave the payee no rights.

2. That section has no relevance to the rights of defendant. It was not the payee, nor was it a holder in due course (see discussion, pp. 36, 37, supra).

B. "LOFENDO," i.e., UNITED PRODUCE, HAS NEVER HAD ANY RIGHTS AGAINST PLAINTIFF ARISING OUT OF THE CHECKS.

Since the payee, "Lofendo", *is* United Produce, it could never maintain a suit against plaintiff to compel it to pay $113,216.50 or $89,813.10 on the basis that the Chicago bookkeeping entries were payment. That would amount to United Produce coming into court and saying:

> "We have drawn a check on you, Merchandise Bank, payable to ourselves. True, we have no funds with you to pay it. True, we are already indebted to you for a half million dollars because we have been criminally swindling you. True, the supposed balance to our credit on the commercial

> ledger was fictitious and fraudulent. But you made some marks with a pen on your books and so you must now pay us another $113,216.50 and another $89,813.10 so as to increase the swindle and fraud by that amount."

Such a suit would be sheer lunacy.

Defendant argues (Br. pp. 22, et seq.) that plaintiff was bound to pay the 6 checks and the 4 checks because when they arrived at plaintiff's office a credit balance *appeared* on the face of United Produce's commercial ledger sheet. Defendant does not deny that United Produce had defrauded plaintiff. It admits that the apparent credit was the result of loan transactions procured by fraud. But it argues that the fraud exhausted itself in inducing plaintiff to make loans (e.g., Br. 121). And it insists that the plaintiff was under the duty to pay out cash even after it discovered the fraud.

The precise argument was rejected in *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717. United's commercial ledger sheet merely recorded the still inchoate results of United's fraud.[14] When plaintiff's clerk sent out the advices of credit and made the various bookkeeping entries, he did so in the mistaken belief that the ledger sheet recorded actual, available funds instead of the product of a swindle. In the *Steinhart* case, Politz gave plaintiff a promissory note. Plaintiff delivered it to a San Francisco bank for collection, which forwarded it to the defendant bank, where the maker had a general account. A clerk presented it to the maker, who wrote on it, "Please charge the same to my account." The clerk then wrote on the back of the note "charged account" and placed on it the usual stamp to indicate that it was cancelled that day. He then charged the amount of the note in the maker's passbook as well as on the ledger sheet of the maker's

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[14]In passing a credit to United's commercial ledger sheet, plaintiff was merely announcing to the customer, United, a willingness to lend to it by honoring checks up to a certain amount. It did not thereby become indebted to United. The loan to United was inchoate. Plaintiff did not have to go through with it when it discovered that it was induced by fraud.

account, drew a check in favor of the San Francisco bank in payment of the note, and mailed it with a letter of advice.

At that time the maker had insufficient funds on deposit with the defendant to pay the note. But, shortly before, he had given a note to the defendant to cover overdrafts, and this was credited to his account and created a sufficient balance to cover the check.

But after the close of business hours, the maker made a general assignment for creditors. Learning that fact, defendant procured from the post office the envelope containing the check, cancelled it, endorsed on the back of the note which it had received for collection the notations "charged in error" and "cancelled in error," and returned it to the San Francisco bank.

Neither plaintiff (the payee) nor the San Francisco bank had any notice of the transactions between defendant and Politz until after the check had been cancelled. The payee sued defendant bank, and defendant had judgment. The question was "Did the transaction between Politz and the defendant constitute a payment of the note?" The court held no (pp. 366, 367):

> "It is not disputed that when the note was presented to Politz for payment, and he wrote on it, 'Please charge the same to my account,' he had no money in the bank to his credit, but was indebted to it in a considerable sum. The request was, therefore, in effect, that the defendant advance or loan to him the money to make the payment, and trust him till he could pay it back. This the defendant, supposing him at the time to be of good credit, seems to have been willing to do, but when, near the close of the business day, it learned that he had made an assignment for the benefit of his creditors and was insolvent, it changed its mind, and concluded not to advance the money. It thereupon got back its check and canceled it.
>
> "At this time the transaction was unknown to the plaintiffs and was incomplete, and as against Politz, the defendant had a clear right, we think, to do as it did.
>
> "And if it be assumed, as claimed by appellants, that the transaction amounted to a contract on the part of defendant to advance the money to pay the note, still, it had a right

to rescind the contract if its consent thereto was given by mistake (Civ. Code, sec. 1689), and that it was so given is shown by the evidence and findings."

While United Produce's commercial ledger sheet on plaintiff's books had a credit figure, *that sheet* was *not* United's account with plaintiff. As Mr. Messenger, an expert as to the significance of plaintiff's records, testified, United had but *one* account with plaintiff; this was reflected and recorded in four ledgers and supporting documents, the true balance of the account could be ascertained only by consulting all the papers together (R. 236-238), and so consulted, there was no credit balance. This testimony supports the trial court's finding X (R. 100):

> "That on November 12, 1948, and on November 15, 1948, as a result of the foregoing frauds perpetrated by United Produce Company on plaintiff, there was an apparent credit balance on the face of United Produce Company's account with plaintiff, *but in fact there was no actual credit balance* on November 12th or at any time thereafter and instead there was an overdraft of over $500,000."

Mr. Messenger's testimony is self-evidently correct. Any review of United's several ledger sheets on plaintiffs books demonstrates their inextricable connection with each other. We make such a review but relegate it to an Appendix, since the finding is already amply supported.

Moreover, regardless of whether United Produce had one or several accounts with plaintiff, the relationship was such that plaintiff was under no obligation to United to honor its checks. As the trial court found (Finding VIII, R. 99):

> "United Produce Company's account with plaintiff was maintained under several writings which together constituted an agreement defining the terms of the relationship between United Produce Company and plaintiff; that under that agreement checks received by plaintiff from United Produce Company drawn on the 'Lofendo account' and represented

> to be remittances from 'Lofendo' were received for collection only, and conditional credits in the amount of the checks were entered in the United Produce Company account with plaintiff subject to charge-back at any time before actual collection of the funds."

And it was agreed that whenever plaintiff deemed checks, endorsed and remitted by United Produce and still uncollected, to be inadequate security, it could apply any credit balance against any sums due to the plaintiff. Thus plaintiff had a right at any time, either before or after the maturity of any debt due it, to apply the balance against the debt no matter how arising.[15]

Defendant is forced to admit that plaintiff had a right of offset against United's apparent credit balance (Br. 26). But, it argues that an offset was not exercised until after the 6 checks and 4 checks arrived. The argument is footless. The time of offset could become material where the superior rights of others were involved, but not as between the bank and its own customer. Patently, United could not sue plaintiff and recover the amount of the apparent credit balance despite the fact that it had defrauded the plaintiff out of over $500,000 and owed it more than that sum, merely because it had demanded that balance before the right of offset was exercised. The offset would be effected in the litigation.

And since "Lofendo" was United Produce, neither could "Lofendo" recover from the plantiff.

And neither can defendant unless by some legerdemain it can establish a "better right" than United Produce. This, as we now show, it cannot do.

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[15]Since defendant confines its discussion of this subject largely to an appendix, we relegate to an Appendix to this brief presentation of the provisions of the agreement.

III.

Defendant Has No Better Right Than United Produce, Which Has None

The only way defendant could acquire any rights whatever in the checks was through "Lofendo". Piercing through the fog of words, the essence of its case is a claim that somehow, some way, it secured through the defrauder "Lofendo", i.e., United Produce, rights against the plaintiff *better than United Produce itself would have* to compel payment of the 6 checks and the 4 checks or to insist that plaintiff become obligated to pay their amount.

There are but two ways whereby one can obtain a greater right in checks than the payee: (1) by becoming a holder in due course, i.e., acquiring for value before notice, or (2) by operation of estoppel. *Here neither situation is present.*

We have seen that defendant was not only not a holder in due course, *it was not a holder at all* (pp. 36, 37, supra). Defendant so admits (Br. 29).

We have also seen that there was no estoppel, because defendant never paid any money or changed its position in reliance on the checks or on an assumption that they were paid, collected or good. The trial court so found (pp. 10, 12, 19, supra), and it therefore concluded:

> "That in connection with the collection of the checks, defendant, not having acted in reliance on any act or omission of plaintiff, could not have any greater rights than its principal 'Lofendo' " (Conclusion IX, R. 115).

Defendant does not attempt to answer this analysis. But it tenders two arguments by which it hopes, in a different way, to show a better right than "Lofendo".

1. An argument having something to do with an alleged "lien" on the 6 checks for $113,216.50 and the 4 checks for $89,813.10 (Br. 45, et seq.).

2. An argument covering plaintiff's internal bookkeeping entries in Chicago.

Each of these arguments disregards the facts of this case.

A. DEFENDANT HAS NO BETTER RIGHT THAN UNITED PRODUCE ON A THEORY THAT IT HAD A LIEN ON THE CHECKS.

Defendant (Br. 50) invokes Cal. Civ. Code, Sec. 3108, which provides that one is a holder for value of a negotiable instrument if he has a lien on it.

The short answer is that defendant had no lien on these checks. After considerable discussion, *defendant so admits* (Br. p. 49). Consequently, we shall cover the subject summarily.

A banker's lien is a possessory lien on tangible property, such as securities or paper held by the bank, to secure a debt due from the owner. Cal. Civil Code, Sec. 3054[16] codifies the law and leaves no doubt that in order for there to be a lien there must be three elements, (a) a debt must be present to be secured, (b) the lien is dependent on possession of the instrument, and (c) there must be tangible instruments or property to which the lien attaches. The lien has nothing to do with mere offset of debts (*Gonsalves v. Bank of America,* 16 Cal.2d 169, 105 Pac.2d 118).[17]

It goes without saying that a "possessory" lien expires when possession is parted with.[18]

Here defendant came into possession of the 4 checks on November 10th and the 6 checks on November 13th, *and it parted*

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[16]Civil Code, Sec. 3054 provides:
"A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business."

[17]The *Gonsalves* case and 9 *C.J.S.* 614, 615, show that the use of the term "banker's lien" to refer to a right to offset a debt due from bank to customer against a debt due from customer to bank is improper. This right is not peculiar to banks but exists as between all creditors and debtors. It is not a lien at all.

[18]The banker's lien of the California Civil Code is no greater than the banker's lien of the law merchant. *Goggin v. Bank of America,* 183 F.2d 322 (9 Cir.); *Berry v. Bakersfield,* 177 Cal. 206, 170 Pac. 415. The banker's lien of the law merchant is a "possessory lien which means only that it [the bank] had a right to hold and retain possession." *In Re Cummins Constr. Corp.,* 72 F. Supp. 409, aff'd, 164 F.2d 983, cer. den. 333 U.S. 881.

with possession on the day of receipt, for it sent them to the plaintiff immediately. Since plaintiff was not defendant's agent for collection but Lofendo's, plaintiff's possession was not defendant's (see pp. 37, 38, supra).

Neither on November 10th or 13th was "Lofendo" indebted to defendant at all, for the account then had a clear collected balance (R. 1181, 1259).

Nor did "Lofendo" become indebted to defendant until November 16th, for after November 10th no checks were honored against the account until that day (R. 1181). Nor did defendant ever give "Lofendo" credit on any of the 6 checks or 4 checks or ever allow him to draw against them.

It follows that defendant never acquired a lien on the checks. There was no debt to it from him at any time while it had possession. And there was no possession when the debt arose or afterwards.[19] Instead, when finally a debt arose, it was too late for defendant to become a holder in due course. One cannot become such after a check reaches the hands of the drawee bank and is presented for payment.[20] Either it is then paid or it becomes overdue, since a check is payable on presentation.[21] If the former, it ceases to exist.[22] If the latter, it is too late for anyone to become a holder in due course.[23]

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[19]Moreover, N.I.L. Sec. 191 (Cal. Civ. Code, Sec. 3266, Ill. Act, Smith-Hurd Ann. St., Ch. 98, Sec. 213) defines a "holder" as a "payee or endorsee of a bill or note, who is in possession of it."

[20]Unless they are "accepted," redelivered under N.I.L., Sec. 191, Smith-Hurd, Ch. 98, Sec. 213, and put into circulation again as live paper.

[21]N.I.L. Sec. 185; Cal. Civ. Code, Sec. 3265(a); Ill. Act, Smith-Hurd Ann. St., Ch. 98, Sec. 206.

[22]10 *C.J.S.,* Sec. 448(c), p. 984; *South Boston Co. v. Levin,* 143 N.E. 816 (Mass.) (N.I.L. Sec. 119; Cal. Civ. Code, Sec. 3200; Ill. Act, Smith-Hurd, Ch. 98, Sec. 140).

[23]N.I.L. Sec. 52(2); Cal. Civ. Code, Sec. 3133(2); Ill. Act, Smith-Hurd, Ch. 98, Sec. 72(2).

Now defendant admits all this. It admits that "Lofendo" was not indebted to it until November 16th. It admits that there can be no lien without a debt, that there was no debt while defendant had possession, and that therefore *"Bank of America never did have a lien on the checks themselves"* (Br. 49).

Therefore defendant could not have become a holder in due course under Cal. Civ. Code, Sec. 3108, which pertains to a "lien on the instrument".

In view of the above concession, it is difficult to see the pertinence of defendant's argument about liens or the pertinence of its citation of *Kane v. First National Bank,* 56 F.2d 534 (5 Cir.) or *Goggin v. Bank of America,* 183 F.2d 322 (9 Cir.). The *Kane* case holds that, when a bank takes paper and sends it to another bank for collection, its lien continues and attaches to the proceeds. But this applies only to a situation where a lien has attached to the paper in the first place, i.e., where there was a debt in existence, on the basis of which a lien could arise. Where, as here, there was no debt while there was possession, no lien has arisen, and what has never come into existence cannot continue.

The *Goggin* case is similar to *Kane.* It has been a debated question whether a pre-existing debt or an advance not made on the faith of the paper is sufficient to permit a lien to attach to a particular instrument or whether new advances must be made "on the faith of the paper". The *Goggin* case held that a lien would attach if there was any debt. It did not dispense either with the necessity of a debt or of concurrent possession of the instrument.[24]

Defendant's discussion of a "lien" then veers off into something quite different (pp. 50-53). It speaks of a "lien" on "pro-

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[24]In footnote 4, 183 F.2d at 326, the *Goggin* opinion cites another case and says, "No banker's lien was asserted for the good reason that no indebtedness was owing to the bank."

Neither the *Kane* nor *Goggin* case involved the rights of third parties, but arose between the depositor's trustee in bankruptcy and the bank. In the *Goggin* case the court remarks (p. 326, fn. 2d col.), "Our case does not concern a controversy between correspondent banks."

ceeds", loose usage for a claim of a right of set-off. It asserts that it became "a bona fide holder for value of a right of set-off". We have difficulty understanding what defendant means. The trial court *found* that defendant paid no value prior to notice and that nothing was ever paid in reliance on the checks or in a belief that they were collected (pp. 10, 12, 17, supra). These findings are not questioned.

As between defendant and "Lofendo", defendant may have had a right to set off any debt which it owed to him against any sums that he owed to it. But here the question does not concern the rights of defendant and "Lofendo" *inter se*. The question is whether plaintiff owes any sum to defendant. We have seen that plaintiff owed none to "Lofendo". Defendant's claim against plaintiff could only arise through "Lofendo". And so we return to the question: Did defendant acquire through the defrauder, "Lofendo", greater rights against plaintiff than "Lofendo" had? Until and unless that is answerable in the affirmative, defendant has no "proceeds" to which it can apply a right of offset as between itself and its customer, "Lofendo".

B. DEFENDANT HAS NO BETTER RIGHT THAN UNITED PRODUCE ON ANY THEORY THAT THE AGENCY RELATIONSHIPS BECAME AUTOMATICALLY TRANSMUTED INTO DEBTOR-CREDITOR RELATIONSHIPS BY REASON OF THE INTERNAL BOOKKEEPING IN CHICAGO.

Defendant's next contention is that plaintiff's act of perforating the 4 checks on November 12th and the 6 checks on November 15th, and its internal bookkeeping at the time, transmuted the relationships of the parties:—that plaintiff automatically ceased to be "Lofendo's" agent for collection and became defendant's debtor, and concurrently defendant ceased to be "Lofendo's" agent and became his debtor! and this, although defendant did not know about what happened in Chicago until informed that it was the result of mistake and fraud. Then, the argument continues, when defendant honored checks drawn on the "Lofendo" account on November 16th, it became "Lofendo's" creditor. And

in this way defendant became a bona fide purchaser "of a right of set-off", although it knew nothing about either credit or debit for several days yet to come.

The premise of this tour-de-force is that the checks were "paid" or "collected" and that the relationship of the parties changed on November 12th and 15th. The premise has no shred of substance, as we show at pp. 79-99.

But assuming the premise, the conclusion still fails: defendant would still not have better rights against plaintiff than "Lofendo" had.

1. The Defendant's Argument Fails for Lack of Consideration for any Obligation of Plaintiff to Defendant.

To say that the relationship of debtor-creditor arose between plaintiff and defendant is merely another way of saying that a contract arose whereby plaintiff promised to pay to defendant. As the court points out in *Guardian National Bank v. Huntington County State Bank,* 187 N.E. 388, 206 Ind. 185 (at p. 389, 2d col.), if any effect is to be given in a case of check collection to mere entries on the collecting bank's books, it must be on the ground that the entries constitute an executory contract to pay. This is common sense.

There would have to be consideration to support such a contract. And such a contract fails where the consideration fails or becomes void for any cause. *Cal. Civ. Code,* Sec. 1689, subd. 3 and 4. And cf. *National Bank of California v. Miner,* 167 Cal. 532, 535, 140 Pac. 27.

Defendant nowhere tries to state what the consideration was. Clearly, *if* there was any, it could be nothing else than defendant's assumption of plaintiff's obligation to the payee of the checks. *If* plaintiff had collected the checks, then as the payee's collecting agent it had become obliged to remit to the payee, and the alleged change of relationship would merely be a contract whereby defendant agreed to assume plaintiff's obligation to the payee in consideration of plaintiff's agreeing to pay defendant—in short,

an agreement whereby plaintiff indemnified defendant for that assumption.

But because of the facts of this case, which differentiate it from any cited by defendant, plaintiff had no obligation at all to the payee, for the payee, "Lofendo" was United Produce (see p. 4, supra).

Defendant thus became subject to no obligation and gave no consideration to plaintiff for any promise to pay *to it* the amount of the checks.

Interpleader

Should "Lofendo"-United Produce claim to be entitled to recover the amount of the checks from defendant, the defendant could not for that reason charge plaintiff's account. It could interplead "Lofendo"-United Produce and the plaintiff and step aside immune, just as it has done with $30,000, the balance remaining after it seized the $113,216.50 and used enough of that sum to replenish losses unconnected with the 6 checks or the 4 checks (cf. Br. 1).

Defendant's Contract with "Lofendo" Precluded any Obligation to Him.

The same conclusion follows by observing the facts from the aspect of the contractual arrangement between "Lofendo" and defendant whereby defendant undertook to collect the checks as "Lofendo's" agent.

Under that contract defendant could not become liable to Lofendo merely upon book entries in plaintiff's books. By the signature card governing the "Lofendo" account, the depositor agreed to be bound by defendant's rules and regulations (R. 93). These provided that "payments for outgoing collections must be final and in good funds" and that "returns must be final and in good funds" (R. 1181, 1189, 1192). Under this contract, no customer placing a check with defendant for collection could contend that it became liable to him until it actually got the funds in hand. *O'Neil v. First National Bank of Lovelock,* 15 F. Supp. 133, considers the meaning of the quoted words and shows that

there is no "final payment" "in good funds" from the standpoint of forwarding bank and its depositor, merely because bookkeeping entries occur in the bank to which the check has been forwarded.

And the same appears from *Dakin v. Bayly,* 290 U. S. 143.

The meaning of the contract between Lofendo and the defendant is fortified by the California Bank Act. In the absence of contract or statute, a bank may accept only cash in payment of a collection. *Luckehe v. First National Bank,* 193 Cal. 184, 187, 223 Pac. 547. The language of the contractual arrangement here as well as in the *O'Neil* case is similar to the language of Section 16(c) of the California Bank Act. That section, as amended in 1943, provided that a bank may send a check for collection "directly to the bank on or by which it is drawn", and

> "in payment thereof there may be accepted either money or the check or draft of the bank on or by which it is drawn, or at or through which it is made payable, or the check or draft of any bank to or through which it has been forwarded for collection, or credit therefor may be accepted with any Federal reserve bank, or with any bank designated as a depositary by the bank allowing such credit" (Cal. Stats. 1943, Ch. 930, p. 2803).

This section protected the forwarding bank from becoming liable to its depositor before it had actual funds available. Correlatively, it protected the depositor from losing his rights by reason of an acceptance by the forwarding bank of something less. Under it defendant could accept as collection only (a) actual money, (b) check or draft, (c) credit on the books of a federal reserve bank, or (d) credit on the books of any bank designated by Merchandise as a depositary.[25]

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[25]Contrast *Dean Tobacco Warehouse Co. v. American National Bank,* 123 Tenn. 365, 117 S.W.2d 746, cited by defendant. There the customer's deposit ticket authorized the forwarding bank to send the check to any bank and to "accept its draft *or credit or conditional payment in lieu of cash.*"

A credit on Merchandise's own books is not recognized by the statute, since plaintiff could not be its own depositary, nor was it defendant's depositary. As defendant says (Br. 37), "Bank of America did not keep money on deposit with Merchandise", but "Merchandise had sums on deposit with Bank of America" (Br. 36). If, as and when debits were made, on plaintiff's instructions, against its deposit on defendant's books in San Francisco, defendant would have actual funds. Otherwise not (Finding IV, R. 96, and see discussion, pp. 12-16, supra).

Until then Lofendo could have no legally enforceable claim against defendant. As said in *Dakin v. Bayly,* supra.

> "The bank [forwarding bank, here defendant] was not bound to assume the relation of debtor until, in the words of the statute, it had received final payment, i.e., cash or its equivalent, and we should not presume that it had done so." (290 U. S. at 149)

Until Lofendo had an enforceable claim against defendant, defendant could have none against plaintiff. And that event never occurred.

Trial Court's Conclusion.

The trial court concluded:

> "That defendant did not become a debtor of Lofendo in connection with the 6 checks totalling $113,216.50 or the 4 checks totalling $89,813.10" (Conclusion VI, R. 114).

2. Defendant's Argument Is Also Destroyed by the Agreement of November 17th and 18th, 1948, as Found by the Trial Court.

On November 17th and 18th, defendant agreed with plaintiff not to act on the advice of credit when received, to return it, and not to charge plaintiff's account. (So found, see pp. 7, 8, supra.)

We deny that the events of November 15th in Chicago created a contract between plaintiff and defendant whereby defendant assumed plaintiff's obligations to "Lofendo" in consideration of plaintiff's agreement to pay defendant. But if it did, then the agreement of November 17th and 18th was binding as a contract

of mutual rescission of the reciprocal obligations of the contract of November 15th.

Defendant admits that this is the necessary effect of the trial court's finding (Br. p. 10).[26] But it seeks to escape the consequences by assailing the agreement. Although it discusses the evidence at some length (Br. 108-117), it concedes that the trial court acted within its province in believing the testimony of plaintiff's witnesses and disbelieving defendant's version (Br. 10, 111). And its own quotations from the record support the finding.[27]

Wherever from facts found other facts are inferable which will support a judgment, it is the duty of the appellate court to draw the inference. *Triangle Conduit etc. Co. v. F. T. C.,* 168 F.2d 175, aff'd, 336 U.S. 956. Consequently, the finding that there was an agreement finds against defendant on all facts on which its argument rests. To answer defendant we need go no further than to show that the evidence supports the finding.

The Agreement of November 17th and 18th Did Not Lack Consideration.

First defendant contends (Br. 117) that the agreement of November 17th and 18th was not supported by consideration. The simple answer is that if obligations arose on November 15th, as defendant claims, the mutual release of those obligations was consideration, each for the other. *Sistrom v. Anderson,* 51

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[26]Defendant states (Br. 10): "In other words, the trial court found in substance that an agreement was made between Merchandise and Bank of America under which Bank of America agreed in effect that Merchandise's payment of the six checks should be rescinded and that Bank of America would repay the amount thereof to Merchandise and would surrender whatever liens or other rights it might have with respect to the six checks and their proceeds." The court did not find that the checks had been paid or that defendant had acquired liens. But if they had been paid or liens acquired, there is no doubt that the agreement found by the court worked a rescission.

[27]In addition, we note that defendant's officer Estribou testified that he knew on November 18th that his bank had made a "commitment * * * with regard to that rescission" (R. 359). We also note that defendant wrote to its branch: "We must recognize their [plaintiff's] instructions" (R. 1174-A).

C.A.2d 213 at 219, 124 Pac.2d 372. And as said in that case, "the fact that [one of the parties] did not in reality wish to be relieved does not alter the fact that there was a consideration" (p. 219).

"Lofendo's" consent to this rescission was unnecessary. It would have been unnecessary even had he not been party to the fraud. The rescission would leave him with his claim against plaintiff (for whatever it was worth). The only theory on which he could ask that the consequences, if any, of the Chicago book entries be maintained would be that they constituted a contract for his benefit. But under *California Civil Code,* Sec. 1559, such a contract may be rescinded by the parties to it without the consent of the third person at any time before he seeks to enforce it.

The Agreement of November 17th and 18 Was Not Voidable for Mistake.

Next, defendant argues (Br. 118) that its agreement of November 17th and 18th was not binding because based on "mistake," i.e., its belief that it was in the clear in the "Lofendo" account.

The contention collapses on its facts, because it is inferable, from the finding that there was an agreement, that it was an agreement in a legal sense, i.e., one having legal consequences; the finding therefore carries with it a finding that there was no mistake, and the evidence unquestionably supports that finding.

While defendant's officers were under the impression that it had not paid out against uncollected funds, this impression was not based on anything said by plaintiff, and defendant's officers testified that they had in mind the possibility that their impression might not be correct, because there were so many items in transit that anything could happen (R. 549, 558, 559). Thus the possibility that the branch might not be in the clear was in the minds of the parties. Yet defendant's head office gave an absolute command to its branch to honor plaintiff's instructions (see P. Ex. 11, R. 1174A). Its counsel testified that when he told

its vice president to write the branch manager "giving him instructions to ignore the advice of credit when it arrived, [he] did not tell [him] to put in any clauses saying if, or provided the Bank of America is not hurt." And "when [he] saw the letter which was later shown to [him] * * * before it was sent out," he observed "that it had no such ifs or buts in it," but he "approved the letter anyway" (R. 701, 702).

One cannot claim mistake because a particular fact proves not to be so, if at the time he made the contract he was conscious of the imperfection of his knowledge or uncertain or doubtful, 48 *C.J.* 763, 70 *C.J.S.* 369, or aware of the possibility that the fact might not be so, *Cleveland-Cliffs Iron Co. v. East Itasca Mining Co.,* 146 Fed. 232 at 237, 238; *McGregor v. Millar,* 166 Kans. 657, 203 Pac.2d 137, 140, and authorities cited in these two cases. As stated in 3 *Corbin on Contracts* (1951), Sec. 598, p. 356, there is no mistake "where the risk of the existence of some factor * * * is consciously considered * * *; instead, there is awareness of the uncertainty * * *." (And see p. 358.)[28]

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[28]Even if defendant had held an absolute belief that the "Lofendo" account was in the black, the fact would be irrelevant in point of law. In order for a mistake of fact to relieve against a contract, the fact must be "material to the contract," *Cal. Civ. Code,* Sec. 1577, 17 *C.J.S.* 497. "Collateral mistake" is not. 5 *Williston on Contracts* (Rev. ed.), Sec. 1569, p. 4380. The mistake must be as to a "basic fact," *Restatement of Restitution,* Sec. 11(3) and Sec. 9. To be material it must go to the essence of the contract, to one of the elements, i.e., the parties, the subject matter, the consideration, the consent, to one of its principal conditions and not merely to the inducement.

As said in *Cavanagh v. Tyson, Weare & Marshall Co.,* 116 N.E. 818 (Mass.), it must "relate[s] to a fact which is of the very essence of the contract * * * material in the sense that it is one of the things contracted about * * *." It must not be "collateral to the essential thing contracted about * * *."

The thing here contracted about was the 6 checks for $113,216.50 drawn on plaintiff, not the "Lofendo" account generally and not *other* checks drawn on or deposited in that account.

The fact that defendant had already honored checks of "Lofendo" against uncollected funds is not material, because it is not related to the 6 checks for $113,216.50. Defendant had not made payments in reliance upon or in connection with the 6 checks. Nor had it incurred the smallest liability by reason thereof.

The Agreement of November 17th and 18th Was Not Vitiated by Misrepresentation.

Defendant finally assails the agreement by arguing that plaintiff misrepresented or suppressed material facts (Br. 121, 122). The argument has no legal substance, but it is sufficient to note that it rests on no facts.

The alleged misrepresentation is plaintiff's statement that the advice of credit had been sent out by error because the 6 checks had been charged against fictitious credits. But this statement is true. Defendant's argument is the very quibble we have answered at pp. 47-50, above.

The fact allegedly suppressed is that plaintiff "had by its negligence permitted the kite to continue" (Br. 122). Yet defendant's witnesses testified that plaintiff's officer, LeRoy, told defendant's officer, Duncan, that plaintiff had discovered a kite and informed him of the very occurrences which defendant now relies on as showing such negligence (R. 543, 547, 634).

Further on Significance of Agreement of November 17th and 18th.

In view of defendant's long attack on the agreement of November 17th and 18th, we may digress momentarily to note its place and significance in the case.

The plaintiff had the right to revoke and rescind its advices of credit, or "payments" made, or book entries, unilaterally, whether defendant agreed or not (see pp. 28, 29, 45, supra), and 65-73, infra). But in fact defendant did agree. That agreement is significant for several reasons: (a) The reason just discussed; if any change in relationship was worked by the book entries in Chicago on November 15th, which we deny, the agreement worked a rescission (pp. 59, 60, supra). (b) Additionally, and regardless of whether the agreement was a binding contract, its violation demonstrates defendant's bad faith (see p. 72, infra). And (c) it is practical construction by the parties of their collection arrangement and negatives the notion that any

change of relationship was effected at all by the Chicago book entries (see discussion at pp. 83, 84, infra).

3. Even if Defendant Assumed an Obligation to Lofendo, It Did Not Become a Holder in Due Course.

It may be added that even if defendant did become "Lofendo's" debtor on November 12th and 15th, which we deny, still it did not become a holder in due course. Under Section 54, N.I.L., one is not a holder in due course, even where he has agreed to pay for a negotiable instrument, if he receives notice before he pays anything upon his promise. This section is in effect both in California (Civil Code, Sec. 3135) and Illinois (Smith-Hurd Ann. St., Ch. 98, Sec. 74).[29] Both states hold that where a bank gives a customer credit on a check but receives notice of infirmity in his title before it pays out upon the credit, it is not a holder in due course. *National Bank v. Uptown State Bank,* 273 Ill. App. 401; *People's F. & T. Co. v. Matthews F. Co.,* 104 Cal. App. 630, 286 Pac. 710.

In *First State Bank and Trust Company v. First National Bank,* 145 N.E. 382, 314 Ill. 269, a check was presented by the alleged payee to the defendant, which credited him with $500 in an account opened in his name and paid the remainder in cash. Plaintiff, the drawee bank, then paid the check. It developing that the check was a forgery, plaintiff demanded return of the money from the defendant. The deposit of $500 credited by defendant to the purported payee had never been withdrawn.

Plaintiff recovered judgment for the $500. The court said (p. 384):

> "A bank is not a holder in due course of a negotiable instrument, if it has given nothing of value therefor beyond

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[29]This section provides:
"Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him."

a credit to the former holder as a depositor, and has not honored his checks upon or in any way bound itself to account to some one for the deposit. * * * A bank which has notice that a deposit is in reality the fund of another may refuse to honor the check of the depositor. * * * To the extent of $500, appellant had not parted with anything of value on the check. When it was apprised of the defect in the title to the check, it could not then be held to be a holder of the instrument in due course to the extent of the sum not paid thereon. Negotiable Instruments Act, § 54. * * * If that sum is repaid by appellant to appellee, appellant will sustain no loss. By refusing to refund, it will increase its property at the appellee's expense."

Here, defendant never paid anything at all, and learned of "Lofendo's" fraud before it sought to act at all. "Lofendo's" title, i.e., United's title, was, of course, defective under the definition of N.I.L. Sec. 55 (*Cal. Civil Code,* Sec. 3136).[30]

IV.

Plaintiff Had the Right to Revoke the Chicago Book Entries. If They Constituted "Payment," Plaintiff Would Be Entitled to Recover any Such Payment, Under Weiner v. Roof. Here Also Discussion of the Situation as to the Four Checks for $89,813.10.

A. DISCUSSION OF THE RIGHT TO RECOVER GENERALLY.

Defendant's basic premise is that the Chicago bookkeeping entries were the equivalent, not only of "collection" and "payment," but of payment to defendant. But defendant's case can in no event be better than if plaintiff had delivered to defendant in San Francisco two bags of gold coin containing $113,216.50 and $89,813.10 and then sought their return by suit in a California court. The right to recover would unquestionably be gov-

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[30]One's title is defective when he obtained it
"by fraud * * * or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or in such circumstances as amount to a fraud."

erned by California law. And so California law is determinative of all questions of rescission and revocation.

The California law is shown by four cases. *Weiner v. Roof,* 19 Cal.2d 748, 122 P.2d 896; *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717; *National Bank v. Miner,* 167 Cal. 532, 140 Pac. 27, and *Aebli v. Board of Education,* 62 C.A.2d 706, 724, 145 Pac.2d 601.

These cases establish that if plaintiff had delivered gold coin to defendant and if defendant was then advised that payment had been made because of mistake or fraud, *before* it paid over the cash to its principal or applied the cash on a debt due it from its principal or before it changed its position, it would be bound to return the funds.

One who pays money through fraud or mistake may recover it. As said in *Aebli v. Board of Education,* 62 C.A.2d 706, 724, 145 Pac.2d 601:

> "* * * Mistake of fact, however, as a general rule furnishes a good ground for relief. Moreover, the mistake need not be mutual, or known to or shared by the party receiving the money. Money paid under a mistake of fact may be recovered back, however negligent the party paying may have been in making the mistake, unless the payment has caused such a change in the position of the other party that it would be unjust to require him to refund. (*National Bank of California v. Miner,* 167 Cal. 532 [140 P. 27].)"

Where payment has been made to another's agent in circumstances in which it could be recovered from the principal if paid directly to him, it can be recovered from the agent unless the latter has, before notice, paid it over to or for his principal. *Weiner v. Roof,* 19 Cal.2d 748 at 752 and at 755, 122 Pac.2d 896 (applying the rule to banks), and 1 *Mechem on Agency* (2d ed.) 1060 (applying it to transactions between forwarding and receiving banks in collections).

The discussion in *Weiner v. Roof* is full and complete. Prior to *Weiner v. Roof,* the California law was settled that

> "one who has paid money through fraud or mistake to an innocent agent, may recover the amount from the agent, unless the latter has paid it to the principal, spent it on behalf of the principal, or paid it to a third party on behalf of the principal."

and

> "The fact that the agent credits the principal with the amount received does not release the agent from his obligation to make restitution so long as he continues to hold the money on behalf of the principal."

Weiner v. Roof approved both of these statements (19 Cal.2d 748, 752). Before *Weiner* it was further held that application by the agent of the funds to a debt due to it from the principal, i.e., charging the principal's account, did not absolve the agent, even though the application had been made before notice, because the book entries could be reversed (*National Bank of California v. Miner,* 167 Cal. 532).

Weiner v. Roof modified that rule by holding that payment by the agent to itself in discharge of a debt to it from its principal is on the same footing as payment by the agent to anyone else at the principal's direction. But it applies the same standard: the application of the funds on the debt may not be made after it "has notice that the original owner of the money who paid it to the agent had a claim for restitution on the ground of fraud or mistake."

Mechem points out that recovery may be had whether payment was made because induced by fraud of the principal alone, of the agent alone, or of both, and also where the payor "would concede that the principal had the right to receive it at the time it

was paid" but something "has since occurred that terminates the right of the principal to receive it" (1 Mechem, p. 1060).[31]

In *National Bank of Commerce of Kansas City v. American Exchange Bank of St. Louis,* 52 S.W. 265, 151 Mo. 320, the court said in a collection case (p. 268):

> "* * * It seems, both upon principle and authority, that where money has been paid by one joint agent to another through mistake, and it has not been forwarded by the latter to the principal, or he has not done some act before notice of the mistake upon the assumption that the payment was good, by which he would suffer some damage if it should be held invalid, the agent so paying may recover back the money thus paid. * * * That this is the general rule there can be no question."[32]

Since plaintiff and defendant were both agents of Lofendo for collection (see p. 37, supra), this rule applies.

Defendant's Argument Is Mostly a Quarrel with the Findings.

It would seem clear that under the rule of *Weiner v. Roof,* supra, the judgment must be affirmed. Assuming that the bookkeeping entries in Chicago on November 12th and 15th constituted payment to defendant, it was a payment to it as agent for "Lofendo." Those entries were occasioned by fraud and mistake. And the payee, "Lofendo," was the defrauder itself, United Produce. Before defendant knew anything of the acts which it now claims to be payment, it was advised of the fraud on November 17th. It could not possibly thereafter make payments to itself as an innocent party having no notice.

The arguments by which defendant seeks to evade the effect of *Weiner v. Roof* are primarily a quarrel with the findings (Br. 56,

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[31]1 *Mechem* 1064 points out that merely placing the funds to the principal's credit is no change of circumstances as will relieve the agent of the duty to repay the party who made the payment.

[32]In the particular case the rule was held not to be applicable because the bank to which the funds were paid had before notice become a *holder in due course.* In the present case defendant never occupied that position.

57). We have discussed these arguments in the Statement of Facts, at pp. 20-23, supra, and shall not repeat.

Illinois Law and the Law Generally.

We have said that California law applies. Illinois law is the same.[33] In *Gillett v. Williamsville, etc. Bank,* 34 N.E.2d 552, 555, 310 Ill. App. 395, the court said that "where a check has been certified by mistake and the rights of third parties have not intervened, the certification may be revoked." *A fortiori,* if a formal certification may be revoked, internal book entries may be.

8 *Zollman on Banks and Banking,* p. 451, says:

> "Banks like other corporations and individuals are subject to the rule that money paid under a mistake of fact may be recovered back.
>
> * * * * * * *
>
> "Conversely, they themselves may recover money paid by them by mistake. Where a collecting bank, under the mistaken belief that collection has been accomplished, pays the owner of the paper, it may recover such payment as paid by mistake or charge back a credit given to the owner unless the owner can show that his situation towards his debtor has through the action of the bank been changed to his prejudice or unless the bank has in fact become the owner of the unpaid instrument."

Defendant's Attempted Limitations on the Right to Recover for Mistake or Fraud Are Unsound.

Defendant argues that one may not recover when he knew the facts (Br. 102-3). But the findings negative the argument; the trial court found that plaintiff did act through mistake, that it was "deceived and misled by reason of the facts found * * * and the fraud perpetrated" (Finding XIII, R. 101).

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[33]In the absence of Illinois decisions plainly showing its non-statutory law to be different from that of California, it would be presumed to be the same. *Lefrooth v. Prentice,* 202 Cal. 215, 223, 259 Pac. 947; *Pratt v. Dittner,* 51 Cal. App. 512, 197 Pac. 365. Of course, it will not now be presumed that another state has a statute similar to that of the state where the court sits, since courts may now look at the statutes of other states. Cal. C.C.P., Sec. 1875(3); *Bowen v. Johnston,* 306 U.S. 19.

Defendant further argues that one may not recover if the mistake arose from his own fault or negligence (Br. 103). This is *not* the law, as the passage quoted at p. 66, supra from *Aebli v. Board of Education,* expressly shows. To the same effect is a decision of this Court, *Carstens v. McLean,* 7 F.2d 322 (9 Cir.).[34]

In *National Bank of California v. Miner,* 167 Cal. 532, 140 Pac. 27, Miner received a check from Johnson drawn on the defendant bank, deposited it with plaintiff bank and received a conditional credit to his account.[35] The check was sent to the defendant, which delivered its cashier's check to the plaintiff. Later that day it discovered that Johnson had no funds with it, demanded back its cashier's check, and refused to pay it. It was sued upon its check.

Judgment against it was reversed. The court said (pp. 536, 537):

> "* * * Extracts are taken from cases which, within their facts, are perfectly sound to the effect that, generally speaking, the certification of a check, or a cashier's check, imports absolute verity. But these cases are, one and all, in connection with facts where the certificate or check has been issued without mistake and certain underlying equities are sought to be advanced in opposition to its payment, or, *they are cases where by virtue of a change in the condition of the holder of the check it would be inequitable to allow the bank either to repudiate it or to advance defense against it.* * * *
>
> "* * * 'It is now settled * * * that money paid under a

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[34]Nor do defendant's citations support it. Its quotation from 40 Am. Jur. 848, Sec. 194 is preceded in the text by the observation that the weight of authority is to the contrary; it is followed by the statement (p. 849) that despite a few earlier decisions, "the later cases establish the doctrine that it is not sufficient to preclude a person from recovering money paid by him under a mistake of fact that he had the means of knowledge of the fact."

[35]The defendant's case there was not as strong as plaintiff's here, because the forwarding bank had already given credit to its own customer, whereas defendant here had done no such thing.

> mistake of fact may be recovered back, however negligent the party paying may have been in making the mistake, unless the payment has caused such a change in the position of the other party that it would be unjust to require him to refund.' And the matter is summed up by this court in the following language: 'An examination of the cases will show that in all well considered adjudications recognition, tacit or express, is given to these principles. *Their ultimate analysis amounts to this: That plaintiff, even if negligent, may recover if his act has not changed the position of an innocent defendant to his detriment.*' * * *"

The court also remarked that "a mere bookkeeper's stroke of pen" may always be rectified by another stroke of the bookkeeper's pen (pp. 538, 539).

Turetsky v. Morris Plan Industrial Bank, 22 N.Y.S.2d 514, is of interest because it comes from the very jurisdiction which has been the root of the mechanical rule on which defendant relies. The court said (pp. 515, 516):

> "Plaintiff sues for the amount of two checks deposited with the defendant bank for collection and for which the drawee bank entered a credit in the defendant's account with it, after having stamped the checks 'Paid'. That credit was charged back about a week later to the drawee bank on the latter's claim that payment of the checks had been made by mistake, since payment had been stopped by the drawer. * * *
>
> "While the drawee was the paying bank, it was also the agent of plaintiff to collect. * * * It has been held that banks paying out money by mistake may recover even though they were negligent in making the mistake, provided no damage had been suffered by the party receiving the money. * * * The drawee bank could demand return of the credit from the defendant as long as it had not in fact disbursed the moneys to the plaintiff. * * * The defendant could, without liability to plaintiff, withdraw the credit to him if in fact there had been a mistake and no damage

resulted to him from the failure to give him timely notice of the stoppage of payment."

Defendant (Br. p. 51) cites *Restatement of Restitution,* Sec. 14, for the statement that a creditor or one having a lien on another's property who receives from a third party any benefit in discharge of the debt or lien need not return it, and it cites Section 13 for the statement that a person who innocently acquires title to something for which he has paid value need not restore it, as he would have to do had he not been innocent or had not obtained title or had not paid value. But plaintiff never paid any sum to the defendant for the purpose of discharging any debt that "Lofendo" may have owed to the defendant. Nor did defendant acquire title to the checks (p. 36, supra) or pay value for them (pp. 12, 17, supra), or have a lien on them (pp. 52-54, supra).[36]

Lack of Good Faith.

Defendant has no standing unless it acquired through the swindler "Lofendo" a better right against plaintiff than "Lofendo" had. To do that it must show that *in subsequently* charging plaintiff's account, it acted *in good faith.* Under *Weiner v. Roof,* supra, that element is essential. But in charging plaintiff's account, defendant violated the commitment it gave plaintiff on November 17th and 18th (so found, see p. 59, supra). A violation of a commitment is obviously bad faith.

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[36]The case of *Hilliard v. Bank of America,* 102 C.A.2d 730, 228 Pac.2d 327 (D. Br. p. 53) is therefore not in point. There one A knew that B owed C money. He voluntarily and knowingly paid C the amount for the purpose of discharging B's debt. The fact that he did so believing that an automobile which B was selling to A belonged to B gave A no right to recover from C any more than if A had paid the money to B and B had paid it to C.

Defendant's Legal Argument About Weiner v. Roof Is an Attempt to Reduce It to Nonsense.

Defendant's legal argument about *Weiner v. Roof* is illusive (Br. 64-72). It contends that the rights of plaintiff to recover were cut off on November 16, 1948 by an automatic offset of a debt to defendant from "Lofendo", of which defendant knew nothing, against an alleged debt of defendant to "Lofendo", of which it also knew nothing. Its alleged debt to "Lofendo" arose, it contends, by reason of the Chicago book entries. This is not so (see discussion, pp. 78 et seq.). But were it so, "defendant did not know until November 22, 1948" after notice of the fraud, "that the 6 checks had been stamped paid, and it never knew until after the present lawsuit had been instituted that bookkeeping entries had occurred at plaintiff's offices on November 15, 1948, with respect to the 6 checks" (Finding XIV, R. 102). "Lofendo's" debt to it arose from honoring checks of "Lofendo" against uncollected funds, but not until late on November 18th did it know that it had done so (see p. 11, supra).

In its own words, defendant's contention is that it was unnecessary for it to make *any* entries or engage in "*any* banking operation" in order to be a *bona fide* purchaser before notice (Br. 64) or even to know that it was purchasing anything or that there was anything for it to purchase!

This argument means that the agent need not, before notice, make *any actual application* of the funds against a debt owed it by its principal, in order to be entitled to keep the funds against the defrauded payer. If this view of the law were correct, then one who has been induced by fraud to pay funds to another as agent for the defrauder may never recover them, *so long as the defrauder is indebted to his agent.*

The contention refutes itself, for it makes nonsense of the reasoning of *Weiner v. Roof,* supra. Prior to *Weiner v. Roof* it was California law that the agent could *never* defend against a return of the money by claiming application upon a debt due

itself. The law protected all creditors, taking before notice, except the agent, and it discriminated *against* him. *Weiner v. Roof* removed the discrimination and put the case of application upon a debt due the agent on a par with application upon a debt of the principal to a third party. Defendant's argument would shift the law so far as to discriminate in *favor* of the agent, by preventing any recovery from the agent where the principal was indebted to it, for defendant would treat the mere existence of the debt as its automatic extinction.

The basic rule is that a payment made under mistake or fraud can be recovered unless the recipient "has thereafter in good faith changed his position" (21 Cal. Law Rev. 312, cited in *Weiner v. Roof,* supra, at 753). Change of position requires some act. If the act consists of discharging the principal's debt to the recipient agent, an *application* must take place. The words of *Weiner v. Roof,* at p. 753, quoting *Restatement of Restitution,* Sec. 143, at p. 579, are that "the agent may * * * apply such money upon an indebtedness of the principal to him." That is, he must make the *application,* in order to receive protection. Or as otherwise worded in the Restatement, at p. 579: "*A settlement of accounts with the beneficiary* is sufficient to bar restitution although the mere crediting to the beneficiary of the amount received is not * * *" Yet, under defendant's argument, neither settlement of accounts with the principal nor crediting his account is needed.

The cases cited in *Weiner v. Roof* at p. 753 all show that some definite act of application is necessary. We summarize these cases in a footnote.[37]

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[37]In *Bradley Lumber Co. v. Bradley County Bank,* 206 Fed. 41, the principal's "note [to the agent bank] was satisfied and was surrendered" (p. 43). In *Lafarge v. Kneeland,* 7 Cow. 454, the moneys were "transferred to and credited on" the agent's account against one of the principals (p. 456): "the agent of the defendant has given credit to his principal and rendered him his account containing the credit." In *Winslow v. Anderson,* 78 N.H. 478, 102 Atl. 310, "defendant's settlement with

What defendant's contention overlooks—here as in other arguments—is that the issue is not one concerning the rights of defendant and "Lofendo" *inter se*—not one concerning the rights as between creditor and debtor or those deriving their rights *under* one of them. Here is a third party whose rights are not derived under, *but are superior to,* those of the two immediate parties, and the question is: Have those rights been cut off? The answer is patently no, because nothing was done before notice.

B. DISCUSSION OF THE RIGHT TO RECOVER WITH PARTICULAR REFERENCE TO THE 4 CHECKS FOR $89,813.10.

Defendant received the "advice of credit" for the $89,813.10. But before it sought to charge plaintiff's account with that sum or to credit the "Lofendo" account, it was already on notice that United Produce and "Lofendo" as a participant in the fraud had swindled the plaintiff out of more than a half million dollars. Not until after defendant awoke, late on November 18th, to the fact that it had carelessly permitted an overdraft in the "Lofendo" account of about $175,000, did it seize on the advice of credit as the basis for charging plaintiff's account so as to obtain funds to cover the overdraft. But the overdraft was not caused by any

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[its principal] of all matters between them was made months before the plaintiffs demanded that he should return to them the overpayment * * *" (p. 312).

Holland v. Russell, 121 Eng. Rep. 773, 1 B. & S. 424, aff'd, 4 B. & S. 1, and *Langley v. Warner,* 3 N.Y. 327, are also cases where the agent applied the money to a debt from the principal and made a settlement of accounts with the principal.

In *Hullett v. Cadick Milling Co.,* 90 Ind. App. 271, 168 N.E. 610, the agent received a check, deposited it in his account, drew one check to his principal and another check to himself. In *Bessler Movable Stairway Co. v. Bank of Leakesville,* 140 Miss. 536, 106 So. 445, the agent received a check, marked the principal's note to itself paid, and gave the principal a credit for the remainder.

In *Cullen v. Donahue,* 121 Atl. 392, 45 R. I. 237; *Mowatt v. McLean,* 1 Wend. 173 (N.Y.); *White v. Rutherford,* 148 S.W. 598 (Tex. Civ. App.), and *Taylor v. Metropolitan Ry. Co.* [1906], 2 K.B. 55, the agent received actual funds, physically turned over part to his principal and with the principal's consent kept part to satisfy a debt to himself from the principal.

reliance on the advice of credit or any assumption or belief that the 4 checks had been paid.

These facts, which *Weiner v. Roof* makes controlling, are clearly found by the trial court (see pp. 17, 19, 20, supra).

A major part of defendant's argument is an attack on the findings as to the time when the events occurred. We have discussed this in the Statements of Facts (at pp. 20 to 23, supra), and shall not repeat. Indeed, defendant was on notice as early as November 10th, for on that day it had concluded that something dishonest was going on between Lofendo and United Produce (so found, R. 105, and see discussion at pp. 101 and 102, infra).

In fact, defendant confines itself to the question of the moment of entering credit to the "Lofendo" account. But merely crediting a principal, no matter when it occurs, will never protect the agent (pp. 67, 68, supra). More important is the moment of *charging* the $89,813.10 *against plaintiff's account.*

And no matter how the evidence is juggled or how "book entries" are separated from "banking operations", that charge did not occur until late on November 18th or on the 19th, i.e., *after* the whole story of the fraud had been told defendant (p. 21, supra).

Thus defendant knew all the facts which would have entitled plaintiff to recover the $89,813.10 from "Lofendo", *if* defendant had already charged plaintiff and turned that sum over to its customer. Consequently, defendant had no right, *thereafter,* to charge the plaintiff.

Defendant quibbles. It argues that even though United Produce had defrauded plaintiff of over $500,000 (Br. 60), it was possible that plaintiff had made no mistake in paying the particular 4 checks. But full knowledge is not necessary. Notice is enough. By averting its gaze defendant could not put itself in the status of a bona fide purchaser for value.

Defendant also quibbles (Br. p. 60) that the 4 checks were not mentioned in the conversation of November 17th and 18th. We have related the circumstances at pages 23-25, supra, and they do defendant no credit. The situation comes to this:

1. Defendant's own conduct misled the plaintiff with respect to the $89,813.10;

2. Nothing that plaintiff did caused the defendant to change its position in the assumption that the $89,813.10 was collected, and it never did change its position in reliance.

3. Defendant was on notice of the fraud;

4. Its conduct in seizing advantage of the advice of credit was surreptitious.

The rule of *Weiner v. Roof,* which in certain circumstances precludes the original payer from recovering his money, is nothing but an application of the equity rules about the intervention of the rights of "bona fide purchasers for value". Defendant must show that it was a "bona fide purchaser of the money". *Weiner v. Roof* cites Restatement of Restitution, Sec. 143, and Restatement of Agency, Sec. 339. Comment c, p. 581 of Section 143 states that

> "If the fiduciary makes a payment *with knowledge of the ground for restitution,* the payment is not a defense. This is true both where the fiduciary obtained the money or other things by a consciously wrongful act and *where before payment over, he was aware of fraud* or duress *of the principal or of the mistake by the transferor.*"

Comment f of Section 339, p. 747, states:

> "If the agent has notice that the other has rescinded or, if he learns of facts from which he should realize that the other is entitled to and will demand rescission, as where the agent or principal was fraudulent in inducing the transaction, a subsequent change of position does not relieve him from the duty of returning what he has received."

On November 17th and 18th defendant knew facts from which it did realize that plaintiff was entitled to rescind as to the $89,-

813.10, and it knew that plaintiff would do so if it should learn that defendant had not acted in reliance on the advice of credit prior to November 17th. And so it concealed the fact as long as it could (see pp. 24, 25, supra).

V.

The Six Checks Were Never "Paid" or "Collected"

In the foregoing discussion we have assumed, for the sake of argument, that the acts transpiring in Chicago—the perforation of the checks and the notations on plaintiff's internal records—constituted "collection" as defendant contends. But this is not the fact.

The trial court *found* that the checks "never were in fact paid or collected" (Finding XII, R. 100). And it held "that the bookkeeping entries of plaintiff did not constitute payment of checks sent for collection" (Conclusion III, R. 114).

Courts repeatedly say, with 8 *Zollman on Banks and Banking,* p. 322:

> "No mere bookkeeping between a bank and its correspondent for the collection of money can change the actual status of the parties or destroy rights which arise out of the real facts of the transaction. * * *"

In *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717, discussed at pages 47-49, supra, the court said (p. 367):

> "* * * And the fact that the note was mutilated, and marked 'canceled,' did not affect the plaintiff's right to sue upon it, since this matter could all be explained and accounted for."

In *Guardian National Bank v. Huntington County State Bank,* 187 N.E. 388, 206 Ind. 185, the court pithily observed (p. 390, 1st col.):

> "Whether the question involved is payment or acceptance, the entries referred to can have no significance. An inten-

tion to pay is not payment, for, *even though one may have procured the money with which to pay, and made an entry in his books showing payment, and delivered the money to his servant or agent with instructions to pay, and started the agent or servant on his way to make payment, yet he may reconsider, recall his servant, change his entries, and there is no payment.* And the same is true concerning the acceptance of an offer; one may decide to accept and prepare a letter of acceptance and give it to his servant with directions to deliver, and the servant may be on his way, but he may be recalled and the terms of the acceptance altered or withdrawn altogether, which is as if all these transactions had merely taken place in the mind."

In *Friedman v. Irving Trust Company,* 300 N.Y.S. 51, it was held that where a forwarding bank sent a check to another for collection, the mere reduction on the latter's books of the indebtedness due to it from the forwarding bank, in an amount equal to the check, is only an accounting procedure and does not constitute payment. That, of course, applies precisely to the entry by plaintiff here on its ledger showing the state of its account with defendant.

Many other courts have held that marking negotiable paper paid, charging the drawer's account, and the like, are irrelevant; e.g., the very recent case of *Bohlig v. First National Bank,* 48 N.W.2d 445 (Minn.), and *Pacific National Agricultural Credit Corporation v. Wilbur,* 2 Cal.2d 576 at 585, 42 Pac.2d 314, particularly where the bank does not go so far as to surrender the paper to the maker (cf. fn. 53 on p. 97, infra).[38]

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[38]See also 8 *Zollman,* p. 222; *Omaha National Bank v. Brady State Bank,* 204 N.W. 796; *Rodgers v. Farmers Bank of Nolanville,* 264 S.W. 491 (Tex. Civ. App.); *Lincoln County v. Gibson,* 255 Pac. 119 (Wash.); *Rock Island Plow Company v. Perry,* 20 S.W.2d 956 (Mo. App.).

The question of what constitutes payment sometimes arises where the forwarding bank becomes insolvent and the maker therefore sues the collecting bank or vice versa. 8 *Zollman on Banks and Banking,* p. 322, says:

"The fact that a collecting bank credits the forwarding bank with the proceeds of a collection does not prevent the owner from recover-

A. DEFENDANT'S ARGUMENT IS VITIATED BY THE MAJOR FALLACY OF IGNORING THE FACTS OF THIS CASE AS TO THE NATURE OF THE COLLECTION CONTRACT.

Defendant concedes that when it received the checks from "Lofendo" and sent them to plaintiff, both it and plaintiff were merely agents of the payee for collection. But it argues that the Chicago bookkeeping entries changed the relationships. By some automatic transmutation, so it contends, it ceased to be the payee's agent and became its debtor, and plaintiff ceased to be payee's agent and became *defendant's* debtor.

This ignores the contractual arrangement *proved* and *found* in *this* case.

A basic rule is that *collection arrangements are contractual.* The holder of a check who wishes it collected, the forwarding bank, and the collecting bank may fix their several relationships in whatever form they wish. The agreement may be stated in express words. It may be filled out by settled custom or usage, or by the course of dealing and practice between the parties. It may be supplemented by statute. It may supplant what would otherwise be the law. *Security etc. Bank v. Southern etc. Bank,* 74 Cal. App. 734, 742, 241 Pac. 945; *Luckehe v. First Nat. Bank,* 193 Cal. 184, 187, 189.

For example, an Illinois case cited by defendant, *American Exchange Nat. Bank v. Gregg,* 28 N.E. 839, 138 Ill. 596, states (p. 840):

> "In determining the legal effect of such transactions we must apply the same rules applicable to all contracts and business affairs, and carry out the intention of the parties, to be

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ing such amount from the collecting bank upon the insolvency of the forwarding bank, since the mere credit can give the collecting bank no additional rights as against the owner. Such credit does not change the relationship of the forwarding bank toward the owner to one of debtor and creditor, or prevent the owner from recovering the proceeds from the collecting bank."

gathered from their acts and declarations, and the accustomed and understood course of the particular business."[39]

8 *Zollman on Banks and Banking*, p. 358, points out:

"Most bank transactions leave but slight evidence in the nature of writings. The reasonable customs and usages of banks therefore are freely resorted to for the purpose of determining the understandings of the parties."

And at p. 389 it says:

"A bank cannot be an agent for collection and a debtor at the same time. It is either the one or the other. Whether it is the one or the other at a particular time depends on the intention of the parties in regard to the disposition of the proceeds as evidenced by custom or agreement, *and hence will frequently be a question for the jury.*"

A finding in a non-jury case is equivalent to a verdict and will differentiate the case from any citations where a different contract was found by the trier.

Another Illinois case, *People ex rel. Nelson v. Peoples Bank & Trust Company,* 187 N.E. 522, 353 Ill. 479, makes the point clear. The opinion (which is too full of meat for partial quotation and too long to quote in full) cuts to the heart of the matter: The original agency relationship cannot turn into something else unless such was the agreement of the parties—(a) the depositor, (b) the forwarding bank and (c) the collecting bank. The forwarding bank does not cease to be the depositor's agent and become his debtor, and the collecting bank does not cease to be the depositor's agent and become the debtor of the forwarding bank, unless and until it was the agreement of the parties that these changes should occur.

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[39]Another of defendant's citations, *Dean Tobacco Warehouse v. American National Bank,* 123 Tenn. 365, 117 S.W.2d 746, remarks (748) that all rules about collections "may be varied by contract, express or implied."

In *Dakin v. Bayly,* 290 U.S. 143, the Supreme Court observed:

> "Could any position taken by the Clearwater Bank [forwarding bank] of its own initiative affect without the depositor's consent the pre-existing relation of principal and sub-agent between the depositor and the St. Petersburg Bank [collecting bank]? We think not." (p. 150)

Nor can the changes in relationship be affected without the agreement of all the parties.

The vital question is therefore this: *What was the contract, in the facts of this case? It is more important to look at the record than to heap up citations involving different sets of facts.*

1. The Findings.

At pages 12, 13, supra, we saw that the trial court found the terms of the contract to be this:

Collection and payment of checks sent by defendant to plaintiff were to be consummated only by a charge made against plaintiff's account on defendant's books in San Francisco, and only upon an unrevoked authorization to make the change. Nothing short of that would change the relationship of the parties, whereby both plaintiff and defendant were merely agents for the payee.

2. The Evidence Supports the Finding.

At pages 13-16, supra, we showed that the finding was required by the evidence. We pointed to the testimony of defendant's own officers as to uniform custom and practice.

We also pointed to the fact that *"collection letters"* were used, and not *"cash letters,"* and we noted the different contractual arrangement implicit in the use of these documents. Where a "cash letter" is used, the entry of credits, the making of bookkeeping entries, may constitute payment unless revoked by charge-

back within a specified time. But in case of a "collection letter," payment can occur only after action upon affirmative advice.

Defendant's Contemporaneous Conduct.

There is other compelling evidence in addition to that noted at pages 13-16, supra.

The law attaches a binding force to the practical or contemporaneous construction by the parties of their contracts. *Universal Sales Corp. v. Cal. etc. Mfg. Co.,* 20 Cal.2d 751, 128 Pac.2d 665; *Tanner v. Title Ins. & Trust Co.,* 20 Cal.2d 814, 129 Pac.2d 383; *Johnston v. Landucci,* 21 Cal.2d 63, 130 Pac.2d 405; *Kales v. Houghton,* 190 Cal. 294, 212 Pac. 21.

As *Cal. Civ. Code,* Sec. 3535, declares: "Contemporaneous exposition is in general the best." One of the leading cases on the subject is *Mitau v. Roddan,* 149 Cal. 1, 84 Pac. 145, and we quote its definitive statement in a footnote.[40]

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[40]"Parties to a contract have a right to place such an interpretation upon its terms as they see fit * * *. And in all cases where the terms of their contract, or the language they employ, raises a question of doubtful construction, and it appears that the parties themselves have practically interpreted their contract, the courts will follow that practical construction. It is to be assumed that parties to a contract best know what was meant by its terms, and are the least liable to be mistaken as to its intention; that each party is alert to his own interests, and to insistence on his rights, and that whatever is done by the parties contemporaneously with the execution of the contract is done under its terms as they understood and intended it should be. Parties are far less liable to have been mistaken as to the intention of their contract during the period while harmonious and practical construction reflects that intention, than they are when subsequent differences have impelled them to resort to law, and one of them then seeks a construction at variance with the practical construction they have placed upon it. The law, however, recognizes the practical construction of a contract as the best evidence of what was intended by its provisions. In its execution, every executory contract requires more or less of a practical construction to be given it by the parties, and when this has been given, the law, in any subsequent litigation which involves the construction of the contract, adopts the practical construction of the parties as the true construction, and as the safest rule to be applied in the solution of the difficulty." (pp. 14, 15).

In this case there are two striking episodes of contemporaneous construction:

(a) Defendant agreed on November 17th and 18th not to charge plaintiff's account (see p. 59, supra). Wholly apart from its binding effect as a contract (see pp. 60-64) this agreement shows the practical construction by the parties of the arrangement between them for collections sent by defendant to plaintiff by means of a "collection letter." It shows that receipt and action upon an advice of credit was an absolute necessity to any change of relationship or rights.

Thus defendant wrote its bank manager, "We must recognize their [plaintiff's] instructions" (R. 1174A). And its counsel advised on November 18th that the plaintiff was "entirely within its rights in revoking this credit" and that defendant would "pay against that credit at their peril" (R. 459).

This agreement of November 17th and 18th that no charges would be made against plaintiff's account was a recognition by defendant that it had no right to take any other position! This was not just a legal conclusion—it was a recognition of the meaning of the collection arrangement. And it is a complete answer to the involved reasoning, later conceived by defendant, by which it now asks for a different interpretation.

(b) Although defendant presumed, on November 17th, from the telephone conversation with plaintiff, that the several book-keeping entries had occurred in Chicago on November 15th (R. 349), it did not enter the collection as paid. It waited until the advice of credit was received on November 19th. It stamped its retained copy of the collection letter as "Paid, November 19, 1948" (R. 1193). And it prepared a credit tag showing collection effected on November 19th (R. 1184).

Defendant's Contract with Its Customer.

Defendant's rules and regulations were incorporated into its contract with customers. Under them no customer placing a check

with it for collection could contend that it was "paid" until defendant obtained the funds in hand. This is also true under the California Bank Act. We showed these facts at pages 57-59, supra.

Evidence Relied on by Defendant.

Against this overpowering mass of evidence defendant merely notes (Br. 35, 36) that the collection letter carried the instruction "Please dispose of all proceeds as indicated by letter 'K' " and that the letter "K" reads: "Credit Bank of America N. T. & S. A. with advice to this branch."

But these instructions do not refer to a mere book entry on plaintiff's records in Chicago. In the context of the relationship of the two banks, the established customs and practices, and the fact that defendant had no account with plaintiff but plaintiff had one with defendant, the request in the collection letter to credit Bank of America was a request by defendant for written authority to credit itself by charging plaintiff's account in San Francisco. (See testimony quoted at pp. 15, 16, supra.) Until all this occurred the funds were not "disposed of."

Plaintiff's Internal Entries in Chicago Were the Same as a Depositor's Notations on His Check Stubs.

The fact is all the clearer when it is observed that the event upon which defendant relies as radically changing the relationship of the parties is merely the entry in plaintiff's private record of the amount of money that defendant owed to plaintiff. Plaintiff had an account with defendant. When it made a deposit with defendant, it made an entry in its private record. When it gave an order to defendant to pay out of its account, i.e., mailed an advice of credit, it made an entry. In every respect this is the same as the act of any man with a checking account who enters his deposits and his checks on his check stubs. These notations are for his own information; they do not affect the state of his account. He may tear up a check before mailing it, or stop pay-

ment, and his bank cannot insist on charging his account because of his entries on his check stub.

The bank in which an account is kept periodically sends to the depositor a copy of its ledger sheet of the account. This is the monthly statement. Defendant sent such a statement to plaintiff. But the depositor does not send to the bank a copy of his check stub or other personal record of his account. And so here, *plaintiff's record of its account with defendant was an internal document, never intended for transmittal to defendant, and no copy, transcript or statement of it ever was sent to defendant* (so conceded, D. Br. 37).

In *Guardian National Bank v. Huntington County State Bank,* 187 N.E. 388, 206 Ind. 185, entries had been made in a check journal and cash sheet. The court held that these entries were not payment because the records were part of a system of bookkeeping maintained for the bank's own convenience.[41]

Most of Defendant's Citations Are Not in Point Because They Involve a Different Contractual Arrangement Than Was Here Proved and Found.

Decisions in cases where a different contractual arrangement between the parties has been proved are not in point. This fact eliminates most of defendant's citations, out of hand.

For example, if the custom of the locality or the arrangement of the parties is that the collecting bank should remit by its own draft, and if the law will permit, some courts have held that the parties have agreed that the collecting bank should become the debtor when it forwards its draft. Such is the case of *O. B.*

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[41]Defendant's brief (p. 21) cites a short passage from 9 *C.J.S.* 502 but fails to quote what immediately follows:

> "Where such items are sent by mail to the drawee bank, it is not bound until it has done something which is the equivalent of paying them or accepting them as a credit to the account of the remitter. *Entries in a portion of the bank's system of bookkeeping which are intended for its convenience and to expedite its business,* but are not intended for delivery to its depositors or as a record of the accounts with them, are not material."

Avery v. Highway Commissioner, 2 N.E.2d 77, 363 Ill. 279 (cited Br. 20).

Cash Letter Cases.

A major example of a kind of contractual arrangement different from that proved here is the case of collection by means of "cash letters" rather than by "collection letters". And a major vice in defendant's argument is that it ignores the stipulated difference between the two (see p. 14, supra). The bulk of bank collections is by cash letter, and the bulk of reported decisions are cash letter cases. They are therefore not in point, because the 6 checks and the 4 checks went forward by "collection letter".

In a cash letter case the forwarding bank gives immediate credit to its depositor and every bank in the collection chain gives immediate credit to its forwarder. The essential significance of a cash letter is that collection is deemed effected unless notice of rejection is given in a specified time.

If a bank gives credit in the first instance but takes the paper for collection and not as owner (see p. 36, supra), the credit is conditional and the paper goes forward on a "cash letter".[42] In such a case each bank in the collection chain also gives immediate credit, likewise conditional. When the collection occurs, the condition is fulfilled, and it is theoretically possible to say that the credit, theretofore conditional, becomes unconditional along the whole collection chain. In such a case some few courts have held that the agency relationship ceases and a debtor-creditor relationship arises between the links of the chain.[43] Most

[42]As stipulated, where credit is given, collection letters are not used.

[43]This was precisely the reasoning in *Dean Tobacco Warehouse Co. v. American National Bank,* 123 Tenn. 365, 117 S.W.2d 746. A conditional credit was given in the first instance and the deposit ticket authorized the forwarding bank to accept a credit from the collecting bank in lieu of cash. The court said that under the agreement of the parties, when the collecting bank gave its credit, the conditional credits became absolute (p. 748).

courts *still insist* that the relationship remains that of principal and agent until the funds are transmitted and become available to the forwarding bank by receipt of notice that the funds have been collected. *Beane v. First National Bank and Trust Company,* 92 F.2d 382 (4 Cir.).

Where a "collection letter" is used, as here, no credits have yet been entered by any bank at all. The essential significance of a collection letter is that collection is deemed not effected until the forwarding bank is advised that it has been and acts accordingly. The debtor-creditor relationship cannot spring into being until a credit is actually entered by the first bank to its customer. Here defendant entered no such credit to Lofendo until after it was notified of the fraud.

We know of no case holding that where credit has never been entered, as in the case of a collection letter, a liability of the forwarding bank to the depositor can spring up before any entry whatever to his account.

People v. Sheridan Trust & Savings Bank, 193 N.E. 186, 358 Ill. 290, cited by defendant, makes the matter clear. There the first bank gave immediate though conditional credit to its depositor, and each bank in the chain of collection gave a like credit to the previous one. Defendant quotes from the opinion but omits a revealing sentence preceding what it quotes and another in the middle of its quotation (p. 191):

> "By the deposit of the check in the general checking account of the candy company, the relation of debtor and creditor was created, but by force of the agreement and custom applicable to out of town *cash* items, the agreement *suspended* the relation of debtor and creditor pending the collection of the check.
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> * * * * * * *
>
> "The credit extended to the candy company [depositor] under the date of June 4 in its passbook *required nothing further to be done on the part of the bank in the way of any*

bookkeeping entries as between the Sheridan Bank and the candy company."

Unlike in the *Sheridan* case, here the 6 checks and the 4 checks were not received by defendant as a deposit, and everything still remained to be done in the way of book entries in the defendant bank, both in the account of Lofendo and in the account of plaintiff.

The following additional citations of defendant are cash letter cases. *Hekler v. Ward,* 21 F. Supp. 710, *Hallenbeck v. Leimert,* 295 U. S. 166, *Gillett v. Williamsville State Bank,* 34 N. E.2d 552, 310 Ill. App. 395, *First National Bank of Corsicana v. Wm. Cameron & Co.,* 149 S.W.2d 132 (Tex.), *Avery v. Highway Commissioner,* supra, *Dean Tobacco Warehouse Co. v. American National Bank,* supra, *Oregon Iron & Steel Co. v. Kelso State Bank,* 129 Wash. 109, 224 Pac. 569; *Storing v. First National Bank of Minneapolis,* 28 F.2d 587, *Rickey v. New York State National Bank,* 7 F. Supp. 29; *First National Bank of Richmond v. Davis,* 114 N. C. 343, 19 S.E. 280; *Maget v. Bartlett Bros. Land & Loan Co.,* 41 S.W.2d 849, 226 Mo. App. 416.[44]

Cases Where the Forwarding Bank Has a Deposit Account with the Collecting Bank.

Another example of a contractual arrangement different from that proved and found here may be seen in cases where the forwarding bank has a *deposit account in the collecting bank* and asks the collecting bank to enter a credit in that deposit account. If the law of the state where the depositor and forwarder are

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[44]That these are cash letter cases is shown either by quotation of the letter, e.g., in the *Avery* case, the letter recites "Items are cash, not collections," or by the fact that the items went through the clearing house, or that immediate credits were entered, or that the letter covered items of more than one customer. All these signify a cash letter, as stipulated (p. 14, supra). In the *Rickey* case it is said that it was the "custom and practice" between the two banks involved for the forwarding bank to charge the account of the collecting bank one day after sending out the item for collection and before advice of collection. This is similar to a cash letter collection and unlike collection letter procedure as stipulated here.

located will permit,[45] then such a credit may be what the parties bargain for. Such is the case of *First National Bank of Corsicana v. William Cameron & Co.,* 149 S.W.2d 132 (Tex.) (cited Br. 34).[46]

In the present case defendant had no deposit account with plaintiff. The reverse was the case (p. 59, supra).

In this connection defendant refers to cases of "reciprocal accounts" between collecting and forwarding bank (Br. p. 32). The present case is not one of reciprocal accounts. But even in such cases, as shown in 8 *Zollman on Banks and Banking* 401 (footnote 1) no alteration in the relationship of the parties is effected upon an entry on the books of *just one* of the banks. It is effected only upon a *reciprocal crediting on the books of the one and debiting on the books of the other. Both* must occur, and the important entry is the charge on the books of the bank where the deposit account is maintained. Cf. *Friedman v. Irving Trust Co.,* 300 N.Y.S. 51, discussed at p. 79, supra. Defendant's own citations show that fact. For example, *Maget v. Bartlett Bros. Land & Loan Co.,* 226 Mo. App. 416, 41 S.W.2d 849 at 858 (first col.) refers to the " 'reciprocal accounts' method of payment, whereby payment is accomplished on the books of the two banks, and, when such crediting and debiting is properly accomplished, such is valid payment by operation of law."

Reciprocal account cases are cash letter cases. The forwarding bank enters a charge to the other on its own books when it sends the collection out. Then when the other bank makes *its* entry, reciprocal entries exist. In a collection letter case there can be no reciprocal entries until an advice of credit comes back and is properly acted on.

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[45]In California this is forbidden. See pp. 58, 59, supra.

[46]As stated (149 S.W.2d 132 at 133): "The Corsicana Bank [collecting bank] * * * debited the account of the School District [drawer of the check] and credited the *regular deposit account* of the Blooming Grove Bank [forwarding bank] with the same amount."

The rationale of reciprocal accounts is illustrated by the discussion in *Dakin v. Bayly,* 290 U. S. 143. Justice Stone there dissented, saying (p. 156):

> "Other circumstances make the present case * * * one for denying to the petitioner any right to assert that the drafts * * * are held upon an agency. The two banks, as the court below pointed out, were mutual agents for collection. *On the record* we must take it that *they dealt with each other as the owners of the collection items* which each bank received from the other without notice of the interest in them of the other's depositors for collection. * * * when banks mutually act as agents for collection, each for the other, and paper *transmitted for collection appears on its face to be the property of the transmitting bank* and remitted for its account, they are entitled to settle their mutual demands for items collected by striking a balance, no matter who the owner of the collected items may be."

Now *only in a cash letter case* can the facts be those on which this reasoning proceeds. A cash letter represents that the original bank has given credit to the depositor, and, therefore, so far as the collecting bank knows, the forwarder may have become the owner.

But a collection letter represents that credit has *not* been given to the depositor. It therefore states that the forwarding bank is not the owner but only the agent. "On the record" of this case the two banks did not deal on the basis that defendant owned the 6 checks or the 4 checks.

In an annotation in 118 A.L.R. 363-382, it is shown that if the collecting bank does not know that the forwarding bank is a mere agent for collection, some courts hold that entries by the collecting bank to an account of the forwarder may affect the rights of the parties, and some courts hold not. But all courts hold that such entries do not affect the rights or alter the relationships of the parties where the collecting bank knows that the forwarding bank is a mere agent for collection. The latter, of course, is neces-

sarily the case where a "collection letter" is used, as the stipulation shows. Cf. *Goggin v. Bank of America,* 183 F.2d 322, 326, fn. 4, 2d col.

Cases Covered by Clearing House Rules.

Another example of cases cited but involving a specific contractual arrangement controlling the rights of the parties is that where the checks go through clearing houses. Parties may be bound by clearing house rules, i.e., by contract, to supplement or supplant the law. *Security etc. Bank v. Southern etc. Bank,* 74 Cal. App. 734, 742, 241 Pac. 945; *Merchants Nat. Bank v. Continental Nat. Bank,* 98 Cal. App. 523, 540, 541, 277 Pac. 354.

B. A SECOND MAJOR FALLACY IN DEFENDANT'S ARGUMENT IS THAT IT CONFOUNDS DIFFERENT SENSES IN WHICH THE TERM "PAYMENT" IS USED.

Plaintiff occupied two different capacities relative to the 6 and 4 checks sent to it for collection. First, it was the bank on which the checks were drawn; as such it was the agent of the maker, United Produce, to pay the checks. Second, it was the bank to which the checks were sent for collection; as such it was the agent of "Lofendo", the payee, to present the checks for payment and after collection to transmit the funds to the payee.[47]

As pointed out in *O'Neil v. First National Bank of Lovelock,* 15 F. Supp. 133 (D.C. Nev.) (already referred to, p. 57, supra).

> "The word 'Payment' appears to have both a broad and a restricted meaning dependent upon its use in respect to particular banking transactions * * *." (p. 137)[48]

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[47]A check may be sent for collection to the bank on which it is drawn. It then occupies the two capacities noted. *Turetsky v. Morris Plan Industrial Bank,* 22 N.Y.S.2d 514; 8 *Zollman on Banks and Banking* 328. *Nineteenth Ward Bank v. First National Bank,* 184 Mass. 49, 67 N.E. 670, cited by defendant, notes the distinction between the two capacities.

[48]In *Maget v. Bartlett Bros. Land & Loan Co.,* 226 Mo. App. 416, 41 S.W.2d 849 at 857 (2d col.) the court, speaking of the "question as to when a check is paid" says, "A general and concise answer to this question may not be given because of the varied elements entering into different transactions."

It may mean (1) payment by the maker through the bank as drawee; or (2) subsequent transmission by the bank as collecting agent to the payee or the payee's forwarding agent.

The question whether there has been payment in the first sense may arise between the maker and the payee or the maker and his bank; for example, where the issue is whether a stop payment order is too late. A number of defendant's citations merely involve "payment" in this sense.[49]

The question whether payment has been made in the second sense arises as between the payee and the collecting bank or between forwarding and collecting bank.

As said in the *O'Neil* case, supra (p. 138):

> "* * * it appears that while receipt of a check or draft through the mail by the drawee bank and actual charge thereof against the account of the drawer and cancellation of the check or draft *constitutes payment thereof so far as the drawer is concerned so that payment thereafter may not be stopped, nevertheless it does not constitute payment in due course until actual receipt by the payee of the amount of money specified or equivalent credit.*
>
> "The agreement entered into between the two banks on February 2, 1930, authorized the Sacramento Bank to 'charge back any item before *final payment,* whether returned or not.' *The expression 'final payment', as there used, clearly means something more than a mere charge on the books* of the drawee bank against drawer bank and cancellation of the check or draft."

Many courts reject the view that stamping checks as paid or making a charge on the books constitutes payment even as against the maker's effort to stop payment. They hold that nothing short of actual disbursement of funds will do, condemn the other rea-

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[49]E.g., *O. B. Avery Co. v. Highway Commissioner,* 363 Ill. 279, 2 N.E. 2d 77; *Nineteenth Ward Bank v. First National Bank,* 184 Mass. 49, 67 N.E. 670.

soning as circular, denominate it as an absurdity and decline to follow it. *Bohlig v. First National Bank,* 48 N.W.2d 445 (Minn.) decided April 13, 1951.

But even the courts accepting the other view refuse to extend the notion of "payment" to remittance by the collecting bank to the holder or the holder's agent.

Even if it were to be said that plaintiff had transferred the funds from one pocket as agent of the maker of the checks, United Produce, to another pocket as collecting agent of the payee, "Lofendo", that would not mean that it had transmitted the funds to "Lofendo" or to his other agent, the defendant. The manner in which the funds were to be transmitted was fixed by the parties' contractual arrangement. And before transmission in the agreed manner, plaintiff had the right to go no further on discovery that maker and payee were one and that the checks were a fraud.

Across-the-Counter Cases.

For a similar reason other cases cited by defendant are inapplicable.[50] Where one has his own deposit account in a bank and deposits in that account a check drawn on the same bank, the act of crediting his account constitutes payment, because the situation is the same as if he had presented the check, received the cash, pushed it back across the counter, and redeposited it.

The rationale of the rule does not apply to mail collections or a case where the payee has no deposit account in the drawee bank. 9 *C.J.S.* 502, quoted at p. 86, fn. 41, supra; *Guardian National Bank v. Huntington County State Bank,* 187 N.E. 388, 206 Ind. 185, 92 A.L.R. 1056, and the recent case, *Bohlig v. First National Bank,* 48 N.W.2d, 445 (Minn.).

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[50]*Hay v. First National Bank of Springfield,* 244 Ill. App. 286 and *American Exchange National Bank v. Gregg,* 28 N.E. 839, 138 Ill. 596.

In the *Guardian* case the court said (p. 389, 2d col.):

> "But we have no such situation here. These checks were sent by mail, and the drawee bank was not bound until it had done something which was the equivalent of paying the checks or accepting them as a credit to the account of the remittor."

Neither "Lofendo" nor defendant tendered checks to plaintiff for deposit.

C. A THIRD FALLACY LIES IN CITING CASES INVOLVING THE RIGHTS OF HOLDERS IN DUE COURSE OR NOT INVOLVING FRAUD OR MISTAKE.

A third major fallacy vitiating defendant's citations is that they involve the rights or obligations of the owner or holder in due course, not of a collecting bank with respect to a previous bank in the collection chain which had not become the owner. Nor do they involve fraud or mistake.

If United Produce (through a dummy) had opened an account with plaintiff on November 12th under the name of "Lofendo" with the 4 checks as an initial deposit, and had deposited the 6 checks on November 15th, and plaintiff had charged United's account and credited this new "Lofendo" account, the situation would have been an across-the-counter one, with the added element of fraud. United could not have contended that there was payment. Transferring a portion of the fictitious credit standing in its name into another name would not surround it with an iron fence so as to protect United in the fruits of its fraud.

American Exchange National Bank v. Gregg, 138 Ill. 596, 28 N.E. 839, cited by defendant, makes this clear. The heart of the decision was this (p. 841):

> "Where a check is offered as a *deposit* and received as such, the check being genuine, *in the absence of fraud* the bank becomes the debtor of the depositor, and the title of the depositor passes to the bank, and no reason is perceived why the business should not be a conclusive and an executed one between the two parties and their depositors."

In *Gillett v. Williamsville State Bank,* 34 N.E.2d 552, 310 Ill. App. 395, the plaintiff was the payee, not her bank which sent the check by cash letter through an intermediate bank to defendant. Defendant marked it paid, but later in the day returned the check and applied the balance in the drawer's account on a note due it from him.

A judgment for defendant was entered upon a directed verdict without evidence by defendant. The judgment was reversed, because an inference was possible that defendant had accepted the check. The acceptance would be ineffective, *if made through mistake,* but that was a question of fact that should have been left to the jury, the finder of the facts (pp. 555, 556, top). And defendant having introduced no evidence, there was enough to infer that the maker had sufficient funds on deposit to pay the check, and there was no evidence of fraud perpetrated by him on his bank.[51]

People ex rel. Nelson v. Sheridan Trust and Savings Bank, 358 Ill. 290, 193 N.E. 186, was a claim by the payee against his own bank [e.g., Lofendo v. Bank of America].

Numerous cases cited from other jurisdictions are not in point for the same reason.

In *Security National Bank of Sioux City v. Old National Bank,* 241 Fed. 1, the plaintiff bank was not a collecting agent. It was a holder in due course.[52] The essential basis of the decision is expressed in one paragraph (p. 8) which states: (1) that where a bank honors a check of a depositor in the belief that his credit

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[51]Relative to the right of defendant bank to offset the maker's note against his balance, the court said that defendant had offered no evidence that the note was mature or that there was a contract permitting offset before maturity. The contrary is true in the present case (see p. 50, supra).

[52]The customer had deposited the checks and received an absolute credit in his general account subject to the right to immediate check. Title to the checks was thereupon transferred to the bank, and it simply became his debtor (p. 8).

balance is larger than it is or in the belief that checks which it has credited to his account will be paid, it is estopped *"as against the owner of* such paid note, check or draft" from revoking or avoiding payment; and (2) that one essential reason for this conclusion is: "because the owner of the note, check or draft has no means of knowing the state of the customer's account."

The rule protects only the owner of the check. The reason is that the owner does not know the state of the customer's account. Yet, here the *owner* and the *customer* were identical, namely, United Produce.[53]

Hayes v. Tootle-Lacy National Bank, 72 F.2d 429, follows the *Security* case, supra, involved the rights of a holder in due course, and recognized that a transaction is not closed or irrevocable where there has been fraud or mistake (p. 432).

In *Oregon Iron & Steel Co. v. Kelso State Bank,* 129 Wash. 109, 224 Pac. 569, the court quotes the passage from the *Security* case, supra, as the key to its decision, emphasizes "the absence of fraud" (p. 572, 1st col.), and the fact that the payee was not party to an illegality (p. 572, 2d col.).

In *Hallenbeck v. Leimert,* 295 U. S. 116, the bank had become the holder in due course, the checks having been deposited in the customer's account and not taken for collection. The court noted (p. 123), "The record reveals no attempt to recover because of fraud, mutual mistake, or other similar circumstance."[54] This was

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[53]The court also emphasized (p. 9) that after defendant stamped the paper as paid and charged the maker's account, it surrendered the paper to the maker and mailed its draft in payment to the plaintiff, who sued upon the draft.

In the present case, as the trial court found, "plaintiff did not notify United Produce Company of the occurrence and never surrendered the 6 checks to it" (R. 101, Finding XIII). Before completion by surrender, the fraud and error were discovered and the checks were returned to defendant (Finding XVI, R. 103). Nor were the 4 checks ever surrendered to United Produce (R. 91).

[54]In California mistake need not be mutual (p. 66, supra).

also a cash letter case and a clearing house case.[55]

Similarly in *Spokane & Eastern Trust Co. v. Huff,* 63 Wash. 225, 115 Pac. 80, the court noted (p. 82) that the "holder of the checks in no way contributed to the mistake" and said that protection was given "to a bona fide holder, who is without notice of any infirmity."

First National Bank v. Noble, 168 Pac.2d 354, 179 Ore. 26, dealt with the right of a bank to recover cash paid a bona fide holder (p. 366) and held that the right would exist if there was fraud (p. 370, 2d col.).

D. DEFENDANT'S CITATIONS ARE IRRELEVANT FOR STILL OTHER REASONS.

To avoid lengthening this brief further, we summarily note that defendant's citations are inapplicable for a variety of other reasons.

In a number of them the question was not whether checks had been collected, but pertained to the rights of the parties in view of insolvencies and the like, in cases where collection was admittedly made and fraud was absent.[56]

A number of the citations rest on basic rules contrary to the law of California and Illinois. For example, federal courts formerly ignored state law and applied their own views as "federal rules". *Erie Railroad Co. v. Tompkins,* 304 U. S. 64, ended this situation in the field of bank collections as well as elsewhere, as stated in

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[55]The court cites two across-the-counter cases, *National Bank v. Burkhardt,* 100 U.S. 686, and *American National Bank v. Miller,* 229 U.S. 517. In each, the holder in due course was a depositor of the bank on which the check was drawn and deposited the check to its credit there. In the *Burkhardt* case (at p. 689) the court makes a statement almost identical with that quoted at p. 95, supra, from the *Gregg* case. In the *Miller* case (p. 520) the court notes that the rule of which it speaks applies only "in the absence of fraud."

[56]*Hekler v. Ward,* 21 F. Supp. 710; *People v. Sheridan Trust and Savings Bank,* supra; *First National Bank of Richmond v. Davis,* 114 N.C. 343, 19 S.E. 280; *Storing v. First National Bank of Minneapolis,* 28 F.2d 587, and *Rickey v. New York State Nat. Bank,* 7 F. Supp. 29.

First Federal Trust & Savings Bank v. Kent, 119 F.2d 151, 155 (6 Cir.). All the federal cases cited by defendant are pre-*Erie* cases. *Security National Bank of Sioux City v. Old National Bank,* 241 Fed. 1, explicitly recognized that it was opposed to a large body of decisions in many jurisdictions, *including California* (citing *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717, discussed at p. 47, supra), but it felt free to ignore the state law (p. 7). No such freedom now exists.

Some of defendant's citations come from jurisdictions resting on the "New York rule", which both California and Illinois reject (see pp. 37, 38, supra). These cases are not in point because they go on the premise that the collecting bank acts as the agent of the forwarding bank and thus owes a duty to it and that the payee can look only to the forwarding bank.[57]

VI.

Discussion of Defendant's Affirmative Claims That Plaintiff Was Negligent, That It Made Misrepresentations, and That It Has Received a Benefit from Defendant.

A. THE QUESTION WHETHER PLAINTIFF WAS NEGLIGENT IS A FALSE ELEMENT IN THE CASE.

Defendant devotes much space to the contention that plaintiff was negligent (Br. 72-108). This contention, we have seen, can be treated only as a counterclaim, not as a defense (p. 35, supra). The alleged negligence is that plaintiff failed to discover that United Produce was kiting checks. This is the same as saying that plaintiff negligently failed to discover that it was being defrauded by United Produce. And, says defendant it, too, suffered loss from the kite.

Plaintiff's alleged negligence is a false element in the case, an attempt to befog the issues.

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[57]E.g., *Hekler v. Ward,* supra; *First National Bank of Richmond v. Davis,* supra; *Storing v. First National Bank,* supra, and others.

1. The Claim of Negligence Is a False Element Because No Negligence, if any, of Plaintiff Had any Causal Relationship to Defendant's Loss.

Proximate cause is necessary before one may hold another responsible because of negligence for loss or damage. And where one's own negligence is the proximate cause, it cannot reimburse itself from another (cf. 19 Cal. Jur. 641-642). As an example, note *Oakland Bank of Savings v. Murfey,* 68 Cal. 455, 9 Pac. 843. There a stranger walked into the office of a notary public and signed a deed, falsely purporting to be the grantor, and the notary acknowledged his signature as that of the grantor. The stranger then went to the plaintiff bank and, representing himself to be the grantee, borrowed money on the security of the deed. The bank later sued the notary for negligence. It was held, not merely that the plaintiff bank was itself negligent, but that its negligence in lending to a stranger was the proximate and sole cause of the loss. And cf. *Edelen v. Oakland Bank of Savings,* 39 Cal. App. 302, 178 Pac. 737.

Here there was no proximate cause between any act or omission of the plaintiff and any loss sustained by defendant. Defendant's loss was caused by its own negligence.

The Findings.

Not only do the detailed facts found so established (pp. 10, 11, 18, 25, supra), but the court specifically found that the loss sustained by defendant in honoring checks on the "Lofendo" account was

> "in no way connected with the 6 checks for $113,216.50 or anything that had occurred with respect to those 6 checks either at the defendant's offices or at the plaintiff's offices or with anything that had been done relative thereto by the plaintiff or the defendant; that the loss was the sole and proximate result of defendant's own carelessness and negligence, as aforesaid." (Finding XXIII, R. 107)

It further found (Finding XXIX, R. 112):

> "that it is not true that any act of plaintiff in allowing United Produce Company to incur obligations of any kind to it or

anything else ever done or omitted by plaintiff in any way proximately caused or contributed to any loss sustained by the defendant in any amount whatever;"

The Evidence Compelled the Findings.

Mr. Tarr, an officer of defendant's branch, was in charge of the Lofendo account. In October, 1948, he was on vacation, and Cosgrove, another officer, relieved him. Cosgrove became interested in the large number of large checks passing between "Lofendo" and United Produce, in both directions, and he felt that the matter required investigation. On Tarr's return the subject was discussed at an officers' meeting (R. 434-436). The testimony of the manager, Estribou, shows that he suspected that a check kite was going on (R. 364, 365). He thereupon gave instructions that his bank must no longer accept United Produce's checks for immediate credit until such time as "Lofendo" "can be contacted and his method of operation discussed." Tarr then prepared a memorandum epitomizing the "unusual operations between" Lofendo and United Produce and stating Estribou's instructions. The memorandum, dated October 22nd, was initialled by all the officers (P. Ex. 12, R. 1174B).

Word was sent to Lofendo to call and explain. About a week later Lofendo and Rosenthal, Secretary-Treasurer of United Produce, called and gave an explanation that satisfied Cosgrove. But Rosenthal was to confirm the explanation by letter. The letter never arrived,[58] and on November 10th Cosgrove's "confidence" in the explanation and in "Lofendo" and United Produce "was shaken" and he "no longer had that confidence" (R. 436-439). He so informed Estribou (R. 439), and Estribou concluded that what was going on between Lofendo and United Produce was not honest (R. 370, 372). Consequently, on November 10th Estribou gave insistent instructions that no checks presented for

[58]Rosenthal was probably afraid of a mail fraud charge if he wrote a letter.

deposit on the Lofendo account were to receive credit. They were to be accepted for collection only and credit was to be given only when collection was complete and the funds in hand (P. Ex. 13, R. 1174C).

The minutes of an officers' meeting of November 10th show (R. 368):

> "The matter of Frank C. Lofendo and United Produce Company was rediscussed. Mr. Estribou *insisted* that all items for deposit should be cleared before credit is received."

Defendant admits that its manager, Estribou, did become convinced of "Lofendo"-United's dishonesty, but it argues that this did not occur until three days later, November 13th (Br. pp. 99-100). Yet its brief quotes Estribou's testimony, under examination by adverse counsel, that his "state of mind about the unethical quality of the transactions between Lofendo and United Produce was just the same on the 10th as it was three days later," namely, that he was "almost positive that something was going on that was not ethical between Lofendo and United Produce Company" (Br. p. 100).

Defendant quotes other testimony on subsequent examination by Estribou's own counsel (Br. 101). But if there are inconsistencies, the trial court resolved them against defendant (Finding XX, R. 105).[59]

Patently, no negligence, if any, of plaintiff prior to October 22nd or November 10th caused any loss to defendant. On November 10, 1948, *defendant had not yet suffered any loss.* The Lofendo account still had a clear collected balance (R. 1181, 1259).[60] Defendant sustained no loss until it paid checks of

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[59]Estribou was an evasive witness, even on questions by the court, e.g., R. 430-432. The trial court was warranted in arriving at a low estimate of the witness' credibility.

[60]The same was true on October 22nd when instructions were first laid down (R. 562).

Lofendo on November 16th (pp. 53, 54, supra). The loss occurred because defendant ignored and violated its own insistent instructions that Lofendo checks were not to be honored against uncollected United Produce checks. The trial court found (R. 107) "that the loss was the sole and proximate result of defendant's own carelessness and negligence."[61]

Defendant argues (Br. 89-90) that it "was not negligent in not having discovered the kite" and asserts (p. 9) that the court found that it was. But defendant *did in fact on November 10th and thereafter believe and conclude that there was a kite or at least that there was dishonest activity* going on between "Lofendo" and United Produce. It is pointless to argue that if it had not so concluded, it would not have been negligent. The trial court did not find defendant negligent for failing to discover the kite; it found it negligent for honoring checks in the teeth of its belief that there was a kite.

2. The Claim of Negligence Is a False Element Because Defendant Is Precluded from Recovering on Its Counterclaim by Reason of Its Own Negligence.

As we have seen (p. 35, supra), defendant's claim of plaintiff's negligence stands on the same footing as if there had been no 6 checks for $113,216.50 or 4 checks for $89,813.10 and no

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[61]The grossness of the negligence is shown by stipulated facts (R. 1181). The instructions were given November 10th. The first checks to arrive thereafter, drawn on the account, were rejected for lack of funds, on November 12th. The first checks to arrive for deposit, on November 13th, were taken for collection only. The same is true of the next group, November 15th. But on the same day—November 15th—another group, for $97,207, arrived, and immediate credit was given. As defendant's manager Estribou testified, "somebody overlooked their hand * * * didn't follow my instructions" (R. 375). The next day defendant honored and paid checks for $109,000. Concurrently, defendant mishandled checks for $75,000 drawn on the account which arrived on November 15th, by "reason of oversight of employees of defendant" (R. 1183).

suit by plaintiff, and as if defendant had sued plaintiff. Defendant's claim is based on negligence. Its own, even if not the sole cause, was certainly contributory negligence, and contributory negligence is a complete bar.

Defendant tries to apply this principle upside down, to defeat recovery by plaintiff. This argument proceeds on the false assumption, already noted, that plaintiff is suing to recover a loss (see discussion at p. 27, supra).

Plaintiff is suing to recover the balance owed it by defendant as a debtor. Its suit is based on contract, not on negligence of defendant. Negligence is brought into the case, not by plaintiff, but by defendant as the basis of a counterclaim. To any such claim, defendant's own negligence is a bar.

As part of the same upside down argument, defendant invokes the maxim that where one of two innocent parties must suffer by the act of a third, he by whose negligence it happened must be the sufferer (Br. 105-106). That maxim, if applicable at all, defeats defendant's counterclaim; for the only "loss" involved in the case is defendant's loss arising from honoring "Lofendo" checks in violation of its own instructions (see p. 27, supra).

3. The Claim of Negligence Is a False Element Because Plaintiff Owed No Duty to Defendant in the Premises.

"Negligence in the air" is not actionable. *The Chester Valley,* 110 F.2d 592, 594 (5 Cir.). And "a bank does not owe a general duty to the public at large to transact its business in a non-negligent manner." 8 *Zollman on Banks and Banking,* p. 255.

As stated in *Routh v. Quinn,* 20 Cal.2d 488, 491, 127 Pac.2d 1:

> "It is an elementary principle that an indispensable factor to liability founded on negligence is the existence of a duty of care owed by the alleged wrongdoer to the person injured or to a class of which he is a member."

In *Buckley v. Gray,* 110 Cal. 339,[62] the court said:

> "there must exist between the party inflicting the injury and the one injured some privity by contract or otherwise, by reason of which the former owes some legal duty to the latter * * *." (p. 343)

In *Savings Bank v. Ward,* 100 U.S. 195 (quoted in *Buckley v. Gray*) an examiner of titles was employed by an owner of property. Relying on his certificate of title, the bank lent the owner money on the security of the property. The title proving bad, the bank sued the examiner for negligence. In holding for the defendant the court said (p. 202):

> "Analogous cases * * * show to a demonstration that * * * the person occasioning the loss must owe a duty, arising from contract or otherwise, to the person sustaining such loss. Such a restriction on the right to sue for a want of care in the exercise of employments or the transaction of business is plainly necessary to restrain the remedy from being pushed to an impracticable extreme. There would be no bounds to actions and litigious intricacies if the ill effects of the negligence of men may be followed down the chain of results to the final effect."

In *Union Old Lowell National Bank v. Paine,* 61 N.E.2d 666, 318 Mass. 313 (1945), and *Cohen v. Tradesmen's National Bank,* 105 Atl. 43, 262 Pa. 76, recovery against banks was denied on this principle. In the *Paine* case a bank officer pledged bonds of bank customers for a personal margin account with defendant, a broker. The bank sued the broker, and the latter

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[62]In both cases cited above demurrers were sustained to a complaint. In *Routh v. Quinn,* a purchaser at a tax sale was denied recovery against the assessor for negligent computation of the tax, it being held that the duty of correct computation was not owed to the purchaser. In *Buckley v. Gray,* plaintiff was denied recovery against the attorney who drew his mother's will for so negligently drawing it as to leave a share to others contrary to the mother's direction and in having the plaintiff witness the will so as to render him incapable of taking under it.

defended on the ground that the bank was negligent in not discovering its officer's scheme. The court held the bank owed the broker no duty in the premise. "At the most," it said, "these contentions mean that the bank was negligent towards customers."

In the *Cohen* case plaintiff gave his check to one who deposited it with his banker, who in turn sent it to defendant bank for collection. Defendant presented it to the wrong bank where it was marked "W.B." meaning "Wrong Bank" and returned. Defendant then misread "W.B." for "N.F." meaning "No Funds" and returned the check with an endorsement of "Not Sufficient Funds". Charging negligence, plaintiff sued defendant for damage to his credit, business and reputation. The court held that defendant owed no duty to the plaintiff. It rejected the contention that "The nature of a bank's business is such that it 'owes a general duty to all the public not to be guilty of negligence' in the transaction of its business."[63]

Assuming that plaintiff's officers were negligent in not discovering earlier that United Produce was swindling it, the duty of care owed by them was to their own bank, not to defendant.

The kite could not continue unless defendant honored checks against uncollected funds. The fact that plaintiff for a period of time honored checks of United was no reason why the defendant should honor checks of "Lofendo." Had it declined to honor "Lofendo" checks, it would have suffered no loss.

Defendant cites no authority to show that plaintiff bank owed defendant bank any duty in the premises. The only case it cites (Br. 104) is *Citizens State Bank v. Western Union,* 172 F.2d 950. There a bank claimed that its own customer, Western Union, was liable to it on an overdraft in the customer's account. The customer sued for a declaratory judgment that it was not. The over-

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[63]See also *Crab Orchard Improvement Co. v. Chesapeake & O. Ry. Co.,* 33 F. Supp. 580, 583; *Shelaeff v. Groves,* 27 F. Supp. 1018 (N.D. Cal.); *Western Auto Supply v. Phelan,* 104 F.2d 85 (9 Cir.).

draft resulted from a fraudulent check kite conducted by Western Union's manager and a confederate, and the bank was negligent in permitting it to occur. The bank owed a duty to Western Union because Western Union was its customer. There was a privity between them. The question was whether the bank could impose on its customer a loss resulting from the bank's own negligence in honoring checks.

If plaintiff owed defendant a duty to discover and stop the kite, defendant owed plaintiff a like duty. Defendant complains that plaintiff failed to discover the kite. But defendant *did* discover it. On November 10th defendant did in fact conclude that there was a kite—something dishonest, going on between "Lofendo" and United Produce. Yet defendant permitted the kite to continue, thereby suffered its own losses, and it did not notify plaintiff (R. 373, 374). If one bank owed a duty to another, then the defendant would be liable to the plaintiff, not merely in contract for the deposit account, but in tort for the $500,000 of losses which plaintiff itself sustained from the check kiting.

4. Answer to the Argument That No Finding Was Made on the Allegation That Plaintiff Was Negligent.

Defendant's discussion of the claim that plaintiff was negligent (Br. 72-89) is both inadequate and inaccurate. But, since the issue is irrelevant for the reasons just discussed, we need not discuss the evidence.

A court need not make a finding on irrelevant matters. *Oedekerk v. Muncie Gear Works, Inc.,* 179 F.2d 821 (7 Cir.); 5 *Moore's Federal Practice* (2d ed.) pp. 2659-2661. Nor need it assert the negative of each rejected contention as well as the affirmative of those it finds to be correct. *Schilling v. Schwitzer Cummins,* 142 F.2d 82, 84 (D.C. Cir.).

Defendant argues (p. 107) that a finding was necessary because all those participating in a fraud are liable for the damages suffered by the injured party! Doubtless every conspirator in a

fraud is liable.[64] But defendant's pleadings made no such absurd charge that plaintiff conspired with United Produce to defraud defendant. They did allege that plaintiff was negligent. But "there is a vast distinction" between negligence and fraud. Fraud is a malfeasance and requires wilful intent to injure, a desire to cheat, another. Negligence, whatever its degree, does not include purpose to do a wrongful act. *Podlasky v. Price,* 87 C.A.2d 151, 161, 196 Pac.2d 608; *Greeley National Bank v. Wolf,* 4 F.2d 67 (8 Cir.). Fraud must be pleaded with particularity, R.C.P. Rule 9b, and a finding of fraud cannot be based on conjecture or surmise. There is no evidence that could sustain such a finding here. *Podlasky v. Price,* supra, at 161.

There is not a scrap of evidence to support a claim that plaintiff was a co-conspirator with United. Nor does defendant contend so.[65]

Furthermore, whenever from facts found other facts are inferable which will support a judgment, the inference must be drawn. *Triangle Conduit & Cable Co. v. F. T. C.,* 168 F.2d 175, 179, aff'd 336 U.S. 956. Here the negative of any possible charge that plaintiff was guilty of fraud is implicit in the finding "that it is not true that * * * anything * * * done or omitted by plaintiff in any way proximately caused or contributed to any loss sustained by defendant in any amount whatever" (R. 112).

So also the negative of knowledge by plaintiff of the fraud is implicit in the finding that it "was deceived and misled by reason of the facts found * * * and the fraud perpetrated" (Finding XIII, R. 101).

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[64]This, of course, is all that defendant's citations hold, e.g., *State v. Day,* 76 C.A.2d 536, 550, 173 Pac.2d 399.

[65]Typical of what it does contend is the assertion that "it must be inferred * * * that Merchandise had knowledge. If it did not actually know about them, it should have known of them" (Br. 88). Fraud may not be inferred, *Podlasky v. Price,* and a charge that one "should have knowledge" is no more than a charge of negligence.

B. ANSWER TO THE CONTENTION THAT DEFENDANT'S LOSS WAS CAUSED BY REPRESENTATIONS OF PLAINTIFF.

Another preposterous counterclaim is that plaintiff induced defendant by false representations to honor "Lofendo's" checks (Br. 89, et seq.). The contention is based on a wire of October 20, 1948 from plaintiff to defendant, not volunteered but sent in response to an inquiry, which defendant's brief partially quotes (p. 93).

There was nothing false or misleading in the wire. But we do not pause to consider that subject, since the counterclaim fails for at least three elementary reasons:

(a) No claim may be predicated on fraud unless there has been reliance and resulting loss. *Carlson v. Murphy,* 8 C.A.2d 607, 610, 47 P.2d 1100; *Podlasky v. Price,* 87 C.A.2d 151 at 158, 196 Pac.2d 608; *Cal. Civ. Code,* Sec. 1709.

(b) There must have been a right to rely; and

(c) The alleged misrepresentation must have been made for the purpose of inducing action. *Cal. Civ. Code,* Sec. 1709. The intention to induce the very action which causes the loss is vital to the claim. *Carlson v. Murphy,* supra.[66]

Finding.

On each of these matters there is a finding against defendant. The trial court found (Finding XXIX, R. 113):

> "that it is not true that the plaintiff ever made any representation to the defendant to induce it to pay any check or checks drawn on the 'Lofendo account' to the order of United Produce Company or to induce the defendant to give anyone whatsoever credit for any check or checks drawn by United Produce on the plaintiff payable to 'Lofendo' or to anyone else; that it is not true that, in reliance on any representation of the plaintiff, defendant ever paid any

[66]Cal. C.C., Sec. 1709 prescribes: "One who wilfully deceives another with intent to induce him to alter his position to his injury or risk is liable for any damage which he thereby suffers."

checks drawn on the 'Lofendo account' or ever gave the 'Lofendo account' credit for checks of United Produce Company."

The Evidence Compelled the Finding.

Defendant received the wire on October 20, 1948, and its branch manager, Estribou, saw it at once (R. 394). But two days *later,* on October 22nd, he laid down his instructions that no credit was to be given the "Lofendo" account on the basis of any United Produce checks before collection, until after a satisfactory explanation could be obtained from "Lofendo" (P. Ex. 12, R. 1174B). Patently, the wire did not persuade Estribou to honor checks.

A few days later Lofendo and Rosenthal of United Produce called on defendant. It was the explanation which *they* then gave, not the wire, upon which defendant relied (R. 439, 419).[67] Accordingly it relaxed its refusal to give credit on United Produce checks.

But the reliance on the explanation vanished when United Produce failed to confirm it by letter. United's failure to keep its promise convinced defendant that what was going on between United Produce and Lofendo was dishonest. Consequently, on November 10th, defendant laid down express instructions that no credit was to be given the "Lofendo" account on the faith of United Produce checks until the funds were actually collected and in hand (p. 102, supra).

At that time, November 10th, defendant had yet sustained no loss (pp. 102, 103, supra). Even if it had theretofore relied on the wire, it had sustained no loss by reason of any such reliance.

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[67]Estribou testified that the report of Rosenthal's explanation had "some effect" to "allay [his] apprehension about United Produce Company checks" and that he "relied upon the report that Mr. Cosgrove made of the explanation given to [Estribou] by Rosenthal and Lofendo" (R. 419).

After November 10th it did not honor checks in reliance on the wire but solely because on November 16th its employees violated instructions not to honor checks at all.

The wire of October 20th was not volunteered. It was a reply to an inquiry and sent as a courtesy (R. 1271), not to induce defendant to do anything whatever. Plaintiff did not send it to induce defendant to give "Lofendo" credit on United Produce checks, because the wire expressly says: "Impossible for us to set limit on acceptance of their [United Produce] checks" (R. 1271). Defendant understood from this caveat that plaintiff "was saying they could make no suggestion then as to whether [defendant] were safe in giving credit on the United Produce Company's checks in any amount" (R. 413, 414).

This sentence was in legal effect a warning not to rely, *Podlasky v. Price,* supra, at 159, and defendant so regarded it. Defendant deemed it so significant that it is *repeated* in defendant's memorandum of October 22nd which recites Estribou's instructions not to give credit until collection (R. 1174B). The effect of the wire was not to seduce defendant but to alert it, as Mr. LeRoy's testimony shows.[68]

Defendant also refers (Br. 93) to a letter written by plaintiff to defendant's Fresno branch September 22nd, because the wire "suggest[ed] you contact your main branch at Fresno who have complete information."

The letter bore the notation, "For your private use, and without responsibility on the part of this bank or its officers" (R. 1273). As shown in *Podlasky v. Price,* supra, at 160, "the office of such

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[68]Defendant told Mr. LeRoy on November 18th "that fortunately they [the branch] had been alerted to the situation and were only paying against collected funds, and consequently they were all right," that they had been "alerted through some communications from the Merchandise National Bank of Chicago" (R. 457).

This communication is the wire, for nothing else is disclosed in the record. Estribou's actions, after receipt of the wire, show that its effect was to alert him.

language was to emphasize that [the parties making the statements] did not pledge their faith to the statements * * *."

And defendant no more relied on the letter than it did on the wire. It was *after* learning its contents by telephone call to the Fresno branch that Estribou gave his instructions of October 22nd. He regarded the letter as saying no more than the wire. The memorandum of October 22nd so recites, for it says (R. 1174B), "Mr. Nelson of the Fresno main office has been contacted and the information that he gave us was no more than what was contained in our wire response."[69]

C. ANSWER TO THE CONTENTION THAT PLAINTIFF RECEIVED A BENEFIT AND THEREFORE MAY NOT RECOVER.

Defendant presents another argument, quite amorphous (Br. 54-56). Its caption asserts that plaintiff "cannot recover from [defendant] its payment of the four and six checks because it received a substantial benefit from their payment."

Once again, it is necessary to recall the *facts of this case:* defendant never paid a cent on, because of, or in reliance on the 6 checks or the 4 checks, or made any payment in any way connected with them.

Defendant argues (Br. 54) that it honored $75,586.86 of checks drawn on the Lofendo account, of which some $51,000 were payable to United Produce and had been endorsed by

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[69]Nothing in the letter was false. Defendant (Br. 94) points to the statement that United was maintaining balances averaging 5-figure proportions, and asserts that there were "noon-day overdrafts." But a "noon-day overdraft" is mere bookkeeping, resulting from the practice of pre-posting, and has no relation to a true balance; the true balance is always greater than the noon-day balance (R. 406; Stipulated, R. 962; cf. R. 1274).

Defendant also points to the statement that United was making proper use of its line of credit, that it was making progress from the standpoint of operations, and that plaintiff entertained favorable regard for the account. This was merely an expression of opinion, as the letter itself indicates by adding, "which is best evidenced by the support we extend." See *Park & Tilford Import Corporation v. Passaic National Bank & Trust Co.,* 30 A.2d 24 (N.J.), a case directly in point.

United Produce to the plaintiff. It then states that the $75,586.86 had been "charged against the credit for the four checks of $89,813.10".

But defendant honored the $75,586.86 before the advice of credit for $89,813.10 was received and not in reliance thereon (see p. 18, supra). Later it tried to take fortuitous advantage of that advice of credit. To say that plaintiff "got the benefit" of the attempted charge of the overdraft against the $89,813.10 is to treat facts lightly.

Similarly defendant states that it honored $109,000 of Lofendo checks in the belief that $97,000 of checks for which it had given credit were good, and it complains that the $97,000 of checks later turned out to be bad when presented to the bank on which they were drawn, the plaintiff. But no act of plaintiff had induced defendant to pay the $109,000. And plaintiff was under no duty to honor $97,000 of checks, when there were no funds. Defendant is not so bold as to make the claim openly. But it does so in substance, for it concludes that plaintiff was obliged to let the defendant later seize the advice of credit for the $113,216.50 to make itself whole for its prior loss.

The essence of defendant's argument is that the checks for $109,000 and some $51,000 of the checks for $75,586.86 were payable to United Produce and had been endorsed by the payee and delivered to plaintiff in payment of debts of United Produce to it (Br. 40, 41, 55). Assuming this to be the fact, it is irrelevant.

Defendant's own statement of the matter shows that, if plaintiff got the checks, it obtained them for value on November 6, 8 and 9, i.e., before notice of any fraud.

Any Lofendo checks received by plaintiff from United Produce were immediately credited against current indebtedness (R. 504, 1280). Moreover, under its agreement with United, plaintiff took all such checks as security for old indebtedness (see Appendix to this brief, pp. 2, 3). Even in the absence of that agreement it

would have had a banker's lien on them as security.[70] Plaintiff therefore took the checks as a holder in due course, an innocent purchaser for value, whether regarded as taking them in payment of the past debt,[71] or as security, either under express agreement or by banker's lien.[72]

Defendant so admits (Br. 55, 56) but tries to evade its effect by saying that plaintiff is not suing on the checks. The point, of course, is that a bank (here defendant) may not recover from a recipient (plaintiff) a payment made on a check drawn upon it if the recipient was a holder in due course or a bona fide purchaser for value or had acted in reliance on the check or on the payment, or had applied it before notice on debts due it. *Weiner v. Roof,* 19 Cal.2d 748 and various cases cited by defendant itself so show (see pp. 41, 96-98, supra).

In addition, as a result of receiving these checks, plaintiff was induced to enter new credits, on the day of receipt, in an equal or greater amount on United's commercial ledger sheet, and these credits were immediately checked against (e.g., R. 763, 928, 1276, D. Ex. PP under dates of November 6, 1948, et seq.). Thus every element necessary for a bank's protection, but lacking as respects defendant's interest in the 6 checks and the 4 checks, is present as respects plaintiff's interest in any checks drawn on the Lofendo account and received by plaintiff from United Produce.

Yet, because plaintiff has the right to be protected and defendant lacks any such right, defendant asks the Court to strip the plaintiff of protection for defendant's benefit.

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[70]*Goggin v. Bank of America,* 183 F.2d 322 (9 Cir.).

[71]*N.I.L.* Sections 25, 52; *Cal. Civil Code,* Sections 3106, 3133; *Smith-Hurd Illinois Statutes,* Ch. 98, Sections 45, 72.

[72]*N.I.L.* Section 27; *Cal. Civil Code,* Sec. 3108; *Smith-Hurd,* Section 47; *Adolph Ramish Inc. v. Woodruff,* 2 Cal.2d 190, 203, 40 Pac.2d 509; *Elgin National Bank v. Goecke,* 129 N.E. 149, 295 Ill. 403.

The situation sums up to this:

(a) The checks for $109,000 and $51,000 were unconnected with the 4 checks for $89,813.10 or the 6 checks for $113,216.50 and were not paid in reliance thereon. Therefore, defendant has no claim against plaintiff predicated on estoppel or change of position (p. 30, supra).

(b) No other action or omission of the plaintiff had a causal relation to the payment of the checks for $109,000 and $51,000. Therefore there can be no recovery on the counterclaims (pp. 100-103, 109-112, supra).

(c) Nor can defendant recover payments made on the ground of mistake since plaintiff was a holder in due course.

Ever since March, 1948, checks had been going back and forth between Chicago and Bakersfield. Each one was a separate matter. Plaintiff held over $500,000 of checks drawn by Lofendo which it had received after November 4th and which defendant refused to honor (pp. 6, 22, supra). Yet during the same period of time, the plaintiff honored and paid checks of over $800,000 to "Lofendo" of which defendant received the benefit.[73]

On defendant's argument, its receipt of the $800,000 from plaintiff would have deprived it of the right to reject the $500,000 of checks, and plaintiff would now be entitled to recover that sum *in addition* to the amounts for which it has been given judgment.

If it were permissible to go behind the 6 checks or the 4 checks to other checks, then with like reason the case would be opened up as to every check passing back and forth from the beginning of the Lofendo account in March 1948 (R. 93). And no matter how far back the effort were to go in reopening closed transactions,

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[73]This fact may be perceived by inspecting Def. Ex. PP, explained at R. 754-757, and P. Ex. 29, explained at R. 747, 1227-1230. Printing of these exhibits was omitted by court order.

the end result would be that plaintiff paid to defendant vastly more than it received.

VII.

Answer to Brief of Appellant Eugene J. O'Riley

Appellant O'Riley is trustee in bankruptcy of United Produce. He was brought into the case by defendant's interpleader counterclaim over a certain $30,000, which would be the balance of the $113,216.50 taken out of plaintiff's account if defendant should prevail (Brief of Bank of America, pp. 1, 2).

The gist of his appeal is that if the judgment between the two banks should be reversed "the trial court should then be required to hear the respective claims of Merchandise and the Trustee" to the $30,000 (O'Riley, Br. 4).

But nothing remains to be tried between O'Riley and the plaintiff, no matter what happens to Bank of America's appeal. He was a party to the trial (R. 171), is bound by the findings and assails none of them. The findings show that "Lofendo" and United Produce are one and the same, that United Produce worked a fraud on plaintiff, and that the 6 checks were drawn as part of that fraud. The essence of Bank of America's argument is that for one reason or another it has greater rights than "Lofendo". But no one has ever pointed to any basis on which United Produce could have any rights at all against plaintiff (see discussion, pp. 41-49, supra).

The trial court stated in its Conclusion No. XI that O'Riley's claim should be dismissed because there was no fund to litigate in view of the judgment in the main case (R. 115). But if Conclusion XI had been omitted, the findings would still support the judgment dismissing O'Riley's claim (R. 117, 118). An appellate court must affirm when the facts found require, regardless of the theory upon which the trial court may have acted. *Helvering v. Gowran,* 302 U. S. 238, 245; *Utah Copper Co. v. Railroad Retirement Board,* 129 F.2d 358, 362.

CONCLUSION

We respectfully submit that the judgment is right, and that it should be affirmed.

Dated: San Francisco, January 23, 1952.

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(Appendix follows)

APPENDIX

(Supplementing Discussion at Pages 49, 50 of This Brief)

1. United Produce Had but One Account with Plaintiff.

Although there were several ledger sheets for United Produce in plaintiff's books, there was but one account. No one of the sheets by itself showed what, if any, actual credit balance United Produce had. No sheet is fully understandable by itself. The credits on the commercial ledger sheets came from a "Drafts Discount Ledger Sheet" and a "Notes Liability Ledger Sheet" (Stipulation, R. 1276). The latter by itself was an incomplete record, requiring consultation with an Assigned Accounts Ledger sheet.[1] This in turn is incomplete for it fails to show what payments had been made. It merely lists the face amount of checks endorsed and remitted to plaintiff by United Produce, whether or not they had yet been collected (R. 1280), but it does not record whether the checks were collected or in fact paid. Whenever such checks were returned unpaid, the practice was to make the charge-back, not on this sheet, *but on the commercial ledger sheet.* Similarly, if discounted drafts were returned unpaid, the charge-back was then made on the commercial ledger sheet. This was plaintiff's practice not only with respect to United Produce but with respect to all customers conducting similar operations (R. 1282).

2. The Contractual Arrangement Between Plaintiff and United Produce.

As found (p. 49, supra), United Produce's account with plaintiff was maintained under several writings which together constituted an agreement defining the terms of their relationship.

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[1]As stipulated (R. 1280), "Nothing on the Notes Liability Ledger sheet reveals or reflects the unpaid balance of United Produce Company's notes held by plaintiff at any time; but in order to ascertain that balance so far as it is shown by any ledger sheet, recourse must be had to United Produce Company's 'Assigned Accounts Ledger' sheet on plaintiff's books."

The first of these writings was the signature card. Thereby United bound itself to all agreements recited in the deposit book (R. 239). That book contained an agreement governing "receiving and handling items for deposit and collection." It provided that, "All items are credited * * * subject to final payment in cash or solvent credits," and that the plaintiff "may charge back any item at any time before final payment, whether returned or not * * *." It further provided that plaintiff "may decline to honor or pay checks drawn against conditional credits" (P. Ex. 7, R. 1169).

In the appendix to its brief defendant argues that this agreement is part of the deposit tag and that deposit tags were not involved in the transactions between United and the plaintiff. Physically, the particular piece of paper marked as the exhibit happens to be the reverse side of a deposit tag. But it was first established that the same agreement appeared in the deposit book (R. 240), no copy of the book being available.

The form of "assignment" of accounts receivable, pursuant to which the checks of its alleged debtors were remitted by United Produce to the plaintiff (P. Ex. 6, R. 1168) contains United Produce's agreement

> "(5) To endorse *for collection* by the BANK forthwith, upon their receipt, all checks * * * received by the undersigned whether in full or partial payment of any indebtedness * * * assigned hereunder."

In the handling of these items for collection, the rights of the parties were governed by the basic agreement in the deposit book.

The assignment also authorized plaintiff "in its discretion and without notice to" United

> "(11) even though the then indebtedness, liability or obligation of the undersigned to the BANK be otherwise not due, to charge the undersigned's account with the BANK with all sums not paid by debtors on the due

dates in said schedule specified and with the full amount of any assigned indebtedness as to which * * * any dispute or defense arises."

The form of promissory notes given by United Produce to plaintiff provided (P. Ex. 5, R. 1163) that

"To secure the payment of this note, *and of any and all other indebtedness, obligation or liability* of the undersigned to the holder hereof due or to become due, whether direct or indirect, absolute or contingent * * * and whether heretofore or hereafter contracted or existing and wheresoever and howsoever acquired by said holder or created, arising or evidenced" United Produce pledged and assigned all accounts receivable "together with any and all other property of the undersigned, or any of them, of every kind and description now or hereafter and howsoever in the possession or control of, or in transit to or from said holder hereof."

It further provided (R. 1163):

"that upon breach of any of the promises herein contained, or upon failure to pay any of said other indebtednesses, liabilities or obligations when due, or in the event that said collateral shall depreciate in value in the opinion of the holder hereof so that it becomes inadequate security, *or if said holder shall feel unsafe or insecure for any reason whatsoever,* said holder may thereupon, or at any time or times thereafter," do a number of things, including the following:

"At any time, whether in case of the insolvency of the undersigned or otherwise, and without notice or demand of any kind, any indebtedness owing by the said holder hereof [the Bank] to any or all of the undersigned [United Produce] * * * of whatsoever kind or description, may be by said holder appropriated and applied hereon, or on any other indebtedness, liability or obligation owing the holder, direct or indirect, absolute or contingent, as well before as after the maturity hereof or thereof."